360 Degrees of Financial Literacy

GETTING TAX SMART

For the smart consumer, tax planning is a year-round event, and there is no better time to start working on your tax strategy than right now. Advanced planning helps to ensure that you take maximum advantage of opportunities to reduce your taxes, particularly those strategies that may take a few months to implement.

GET CREDIT FOR CARE

If you pay someone to care for a child under age 13 or for an incapacitated adult so that you can work, you can get a dependent tax credit. Currently, the amount of expenses eligible for the credit is $3,000 for one qualifying dependent and $6,000 for two or more.

Under a law that became effective in 2003, the maximum credit increased to 35 percent of expenses for taxpayers with an adjusted gross income (AGI) of $15,000 or less, and phases down to a minimum credit of 20 percent for taxpayers with an AGI over $43,000.

MAKE RETIREMENT PLAN CONTRIBUTIONS

Pre-tax contributions to an employer-sponsored retirement savings plan reduce the amount of taxable wages you report on your return, making qualified retirement plans an excellent way to cut your tax bill.

If you have a 401(k) plan at work, the top annual contribution for 2005 is $14,000, up from $13,000 last year. If you're 50 or older, you're eligible for the "catch-up" provision, which means you can contribute up to $18,000 this year. For traditional and Roth IRAs, the maximum annual contribution remains the same as last year, $3,000 or $3,500 if you're age 50 or older.

IMPROVE YOUR RECORDKEEPING

Many people miss valuable deductions because they don't keep records of deductible expenses. Start now by setting up a system for tracking deductible expenses and storing receipts. If you just can't do it, you can get part way there by ordering copies of cancelled checks from your bank at the end of the year, but that's a more expensive option.

PLAN YOUR INVESTMENT GAINS

While you should never make investment decisions based solely on tax considerations, proper planning can reduce your tax bill significantly. For example, if it makes sense from an investment standpoint, wait to sell appreciated assets until you have met the one-year holding period to qualify for long-term capital gains treatment.

Timing losses to offset your gains is another tax-reducing strategy. Capital losses can be used to offset any capital gains you have, plus up to $3,000 of other income, such as salary. Any excess loss can be carried forward to future years.

GIVE AWAY SOME ASSETS

If you're thinking about liquidating appreciated assets to pay your child's college tuition, consider this: Gift the stocks or mutual fund shares to your child and have the child make the sale and pay the tuition bill. If your child is in the 15 percent tax bracket, the 10 percent long-term capital gains rate would apply, compared to the 20 percent tax you would likely face. For assets held for five years or more, a capital gains tax of 8 percent applies to those in the 15 percent tax bracket.

USE YOUR VACATION HOME WISELY

If you own a second or vacation home, check with a CPA to determine whether you get a better tax break by treating the property as a second residence or as a rental property. You will need to carefully work out a plan, since the number of days you personally use the home is critical to its tax treatment.

GET ADVICE EARLY

Rather than waiting until the end of the year or just before your return is due, contact a CPA now for advice. This will help you to take charge of your tax situation.

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