

SPECIAL YEAR-END ISSUE!

On Target Tax Planning Tips and Strategies

April 15th, 2006 (March 15th for calendar year corporations)—the deadline most individuals and businesses face for filing their 2005 income tax returns—may seem a long way off, but now is the time to start preparing for it. A little bit of planning now can help avoid the headaches and hassles that come with a last-minute rush as the filing deadline approaches. In this special year-end issue, *TaxView* offers its annual collection of tips, suggestions and reminders, which readers may find useful in tax-planning discussions with their accountants or financial advisors.

Acceleration or Deferral of Income and Deductions

The right year-end planning in the area of income and deductions can provide significant income tax savings for many filers. Since there will be no change in marginal tax rates between 2005 and 2006, accelerating or deferring income or deductions represents a time-value issue for taxpayers who expect to remain in the same tax bracket from year to year. The same decision-making process should be used in considering prepayment of expenses to accelerate deductions into the current year. All decisions regarding expense and income acceleration or deferral should be made only after determining the effect they would have in exposing the taxpayer to the alternative minimum tax (AMT) for the tax year in question. The most common expenses that may trigger the AMT are real estate taxes, state and local income taxes and itemized deductions subject to the 2% limit.

Timing of Capital Gains and Losses

For investors whose portfolios include underperforming assets, selling them before the end of the year can provide some tax savings. A loss on the sale of securities such as stocks and bonds can be used to offset other capital gains and any remaining loss is deductible against ordinary income up to \$3,000 for federal income tax purposes in the year in which the sale occurs. Losses exceeding \$3,000 may be carried forward to future years. Investors considering the sale of a depreciated security at a loss must be careful not to run afoul of the “wash sale” rule. The rule disallows deductibility of a loss on the sale of a security if the taxpayer acquires “substantially identical” securities within 30 days before or after the date of the sale.

Treatment of Dividends

Dividend income, which prior to the Tax Relief Act of 2003 was treated as ordinary income and subject to tax at rates as high as 38.6%, is now treated the same as long-term capital gains and subject to tax at a maximum rate of 15%. However, not all types of dividend income are treated as “qualified dividend income” under the new tax law. Dividends paid on common stock of domestic corporations and certain foreign corporations generally qualify for the favorable treatment, but dividends such as distributions from money market mutual funds do not. Other types of dividend distributions, such as from real estate investment trusts (REITs) and certain preferred stocks, also may not qualify. Most qualified dividend-producing stock must be held for at least 60 days in the 120-day period beginning 60 days prior to the ex-dividend date in order for the reduced tax rate to apply.

Charitable Contributions

Accelerating payment of cash contributions to charity into the current year is a common year-end tax planning strategy to increase deductions. If the charitable contribution is made with a personal check, the contribution is considered for tax deductibility purposes to have been made on the date the check is mailed to the charity (assuming the check eventually is cashed and cleared). Gifts of appreciated marketable securities to a qualified charity are deductible in the amount of the fair market value of the security, regardless of the taxpayer’s cost basis as long as the stock was held for at least one year and one day. This strategy avoids the capital gains tax that would have resulted had the security been sold and the cash proceeds donated to charity. This strategy is beneficial when donating shares of stock with little or no cost basis since it eliminates a future capital gains tax. The taxpayer is free to repurchase shares of the same security immediately on the open market, thus stepping up the tax basis of that



POTENTIAL TAX PLANNING OPPORTUNITY FOR CERTAIN NEW JERSEY RESIDENTS

There is a planning opportunity for individuals who pay New York City Unincorporated Business Tax (referred to as NYC-UBT), either directly or through a partnership, who are also New Jersey residents. With New Jersey personal income tax rates now at historical highs (up to 8.97%), certain New Jersey residents may be able to obtain additional credits on their New Jersey income tax returns. It should be noted that computer generated returns will not automatically compute the proper credit, and it is likely that many taxpayers meeting the criteria are not taking advantage of this additional credit. The potential savings can be substantial. If you have income which is being taxed for both New York State and NYC-UBT purposes, then an additional credit of up to 1.27% may be available. For example, if the income being taxed is \$100,000, then the tax savings can approximate \$1,270. For \$1,000,000 of income the savings could reach \$12,700, and so on. Therefore, if you meet these criteria or know of someone who does, you should contact Geller & Company's Charlie Pomo at 212-583-6000 or cpomo@gellerco.com for further information.

security in the taxpayer's portfolio. As noted above, this strategy should only be done if the appreciated marketable security was held for more than one year. If they have been held for a shorter time, the deduction is limited to an amount equal to the adjusted cost basis of the appreciated securities.

Maximizing Retirement Plan Contributions

Contribution limits have been increased for many types of tax-qualified employer sponsored retirement plans, including 401(k), 403(b) and 457(b) plans. Eligible participants may make tax-deductible contributions up to \$14,000 for 2005 and \$15,000 for 2006, with effective deferral limits indexed to increase in \$500 increments in subsequent years. In addition, those aged 50 or older may contribute an additional \$4,000 in 2005 as an age-based catch-up contribution, with the figure increasing to \$5,000 in 2006. Thereafter, catch-up contribution increases will be indexed to the cost of living and rise in \$500 increments as warranted. Compensation that may be taken into consideration in determining employer contributions to tax-qualified plans and 403(b) plans under Internal Revenue Code (IRC) section 401(a)(17)—a section of the tax code governing qualified pension, profit-sharing and stock bonus plans—is \$210,000 in 2005; subsequent increases will be indexed to the cost of living in \$5,000 increments. Traditional and Roth IRA contribution limits are \$4,000 for 2005 and 2006. IRA owners aged 50 and older can make catch-up contributions of \$500 in 2005 and \$1,000 in 2006.

Section 179 Write-Offs

Under IRC Section 179, small businesses are eligible to take deductions for purchases of "personal property" worth up to \$105,000 in 2005. "Personal property" includes items such as computers, furniture and office equipment, but not land, buildings or improvements to buildings. The total amount of the deduction allowed is reduced if purchases total more than \$420,000 in 2005, and individual taxpayers cannot deduct more than their taxable income from a business. This write-off is scheduled to continue through at least 2007 under legislation passed by Congress in October 2004. Also, leasehold improvements to nonresidential real property placed in service before January 1, 2006 may be depreciated over 15 years rather than 39.5 years, although for AMT purposes the longer depreciation span still applies.

Gift Tax Exclusion

Individual taxpayers are entitled to give gifts of up to \$11,000 per donee and married couples can double the gift to \$22,000 to any number of recipients in 2005 without incurring any gift tax liability, thanks to the Gift Tax annual exclusion. (The gift tax exclusion will increase to \$12,000 per donee/\$24,000 per married couple for 2006.) The maximum combined estate, gift and generation-skipping transfer tax rate drops to 47% in 2005 from 48% in 2004; it drops to 46% in 2006 and 45% the following year. The cumulative tax-free transfers for 2005 remain at \$1,500,000, but gradually increase to \$3,500,000 in 2009 for estate tax purposes. For gift tax purposes the cumulative tax-free transfers remain at \$1,000,000.

Energy Tax Incentives

The Energy Tax Incentives Act of 2005 (PL-109-58) includes \$14.5 billion in tax incentives aimed at improving energy production and efficiency. Most become effective after December 31, 2005. Several credits are available for individual taxpayers, although they are not allowed for AMT:

- A nonrefundable tax credit for the purchase of solar water-heating, photovoltaic equipment and fuel cell property for residential use; maximum credit is \$2,000.
- A nonrefundable credit for the purchase of fuel-efficient vehicles, including hybrids, ranging from \$650 to \$3,400, depending on weight class and fuel economy.
- A \$500 maximum lifetime nonrefundable credit for the non-business purchase of energy-efficient improvements (furnaces, hot water heaters, etc.) meeting certain specifications for use in existing homes.

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