

Holiday Tax Planning Tips

Now that the turkey has been fully digested and your energies are focused on the imminent holidays, save some mental energy for some tax planning techniques that may save you enough to pay for those holiday gifts.

The threshold issue of year-end tax planning is whether you will itemize your deductions or not. For 2003, the standard deduction for married persons filing joint returns is \$9,500 with an additional \$950 for each person age 65 or older and each legally blind person. The standard deduction for single persons is \$4,750 with an additional \$1,150 if the person is age 65 or older or legally blind. Run a quick check to determine if it is likely that you will itemize. Usually, if you owned a home for at least half of the year, you will itemize as a result of the mortgage interest and real-estate taxes paid. If you itemize, the overall planning strategy is to accelerate deductions and defer income.

Most individual taxpayers are on the cash basis. They report income when constructively received and deduct expenses when “paid”. However, in our advanced society, what it means to pay for something has expanded beyond handing over cash for an item. Using a *debit* card is the closest method to paying with actual cash and it is easy to see that you are said to “pay” for something at the time you use such a method.

What about when one uses a credit card? At a minimum, you do not actually pay the charges until the bill arrives and, if you are one of the many people who carry a balance on their credit card, you do not pay the charges until a later date. The government permits items to be deducted in the year the charge is made, not when the underlying credit card bill is actually paid. This rule is important in the area of year-end planning because it enables you to deduct items in the current tax year that you do not actually pay for until the following tax year.

Charitable Arithmetic

The first and simplest technique is to make charitable contributions prior to the end of the year. If you do not have the cash now, charge the contribution and pay for it in January, or even later. If you have an automobile that is just not worth selling, contribute it. Many charities will even arrange for the pick up of your automobile as well as other items. Charitable deductions can generally be taken for the fair market value of the contributed property. This rule applies to most types of appreciated property, including securities. Giving appreciated property to a charity often makes much more sense than contributing cash, too. For example, suppose that you have one share of stock worth \$110 that you acquired 50 years ago at cost of \$10. If you sell it, you have a \$100 capital gain on which you will likely pay \$20 in tax leaving you with \$90 to contribute to the charity. The charity only gets \$90 and you can only deduct \$90. Conversely, you could contribute the share of stock, deduct \$110 and the charity would receive \$110 after selling the stock as it will not have to pay tax on the resulting gain.

Another area is medical expenses. These are only deductible to the extent that they collectively exceed 7½% of the taxpayer(s) Adjusted Gross Income (AGI). This is usually an unattainable threshold for working individuals, but not such a high level for retired persons who are likely to have lower incomes and greater medical expenses. Do a quick estimate of whether you may exceed this threshold. If so, accelerate all medical expenses that you can control. If you are short of cash, remember that the credit card rule applies here too.

Miscellaneous Items Can Add Up

A final area of expenses that can be accelerated is miscellaneous itemized deductions. Similar to medical expenses, total miscellaneous itemized deductions are only deductible to the extent they exceed a percentage of the taxpayer(s) AGI, in this case only 2%. Thus, it is important to do a quick calculation to see if it is likely that you will exceed this threshold and, if so, accelerate those expenses.

Popular miscellaneous itemized deductions include tax preparation charges, safe deposit box fees for securities and IRA custodial fees. But there are numerous other miscellaneous itemized deductions, many of which relate to investments. Most people are aware that investment management fees are deductible, but many fail to realize that the costs for traveling to their investment manager's office are deductible as are publications for investment purposes. Another commonly overlooked deduction is gambling losses. Gambling losses are deductible only to the extent of gambling income, but if you had winnings, you may as well offset them with any losses you incurred.

I have focused on the acceleration of deductions and not the deferral of income because most people can only control the former. If you carefully take control of your deductions and time them right, you can save yourself a great deal of money. As always, if you have any questions, you should consult with your tax preparer.

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