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Individual year-end tax planning ideas

As we approach year end, it's again time to focus on last-minute moves you can make to save taxes — both on your 2014 return and in future years.
Here are a few ideas.

Maximize the benefit of the standard deduction. For 2014, the standard deduction is $12,400 for married taxpayers filing joint returns. For single taxpayers, the amount is $6,200. Currently, it looks like these amounts will be about the same for 2015. If your total itemized deductions each year are normally close to these amounts, you may be able to leverage the benefit of your deductions by bunching deductions in every other year. This allows you to time your itemized deductions so they are high in one year and low in the next. For instance, you might consider moving charitable donations you normally would make in early 2015 to the end of 2014. If you're temporarily short on cash, charge the contribution to a credit card — it is deductible in the year charged, not when payment is made on the card. You can also accelerate payments of your real estate taxes or state income taxes otherwise due in early 2015. But, watch out for the alternative minimum tax (AMT), as these taxes are not deductible for AMT purposes.

Consider deferring income. It may be beneficial to defer some taxable income from this year into next year,

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especially if you expect to be in a lower tax bracket in 2015 or affected by unfavorable phaseout rules that reduce or eliminate various tax breaks (child tax credit, education tax credits, and so forth) in 2014. By deferring income every other year, you may be able to take more advantage of these breaks every other year. For example, if you're in business for yourself and a cash-method taxpayer, you can postpone taxable income by waiting until late in the year to send out some client invoices. That way, you won't receive payment for them until early 2015. You can also postpone taxable income by accelerating some deductible business expenditures into this year. Both moves will defer taxable income from this year until next year.

Secure a deduction for nearly worthless securities. If you own any securities that are all but worthless with little hope of recovery, you might consider selling them before the end of the year so you can capitalize on the loss this year. You can deduct a loss on worthless securities only if you can prove the investment is completely worthless. Thus, a deduction is not available, as long as you own the security and it has any value at all. Total worthlessness can be very difficult to establish with any certainty. To avoid the issue, it may be easier just to sell the security if it has any marketable value. As long as the sale is not to a family member, this allows you to claim a loss for the difference between your tax basis and the proceeds (subject to the normal rules for capital losses and the wash sale rules restricting the recognition of loss if the security is repurchased within 30 days before or after the sale).

Invest in tax-free securities. The most obvious source of tax-free income is tax-exempt securities, either owned outright or through a mutual fund. Whether these provide a better return than the after-tax return on taxable investments depends on your tax bracket and the market interest rates for tax-exempt investments. With the additional layer of net investment income taxes on higher income taxpayers, this year might be a good time to compare the return on taxable and tax-exempt investments. In some cases, it may be as simple as transferring assets from a taxable to a tax-exempt fund.

Again, these are just a few suggestions to get you thinking. Please call us if you'd like to know more about them or want to discuss other ideas.

Does your business need a buy/sell agreement?

It is important that businesses with more than one owner have a written buy/sell agreement specifying what happens when an owner withdraws from the business. A buy/sell agreement is a contract between the owners (or the owners and the business entity itself) that establishes rules and restrictions applicable to changes in ownership.

The typical buy/sell agreement provides that an owner's interest in the business will be sold (or at least offered for sale) at a specified price to the other owners and/or to the business entity itself upon the occurrence of specified events. This prevents unwanted persons from becoming members of the ownership group and ensures a ready market for closely held ownership interests. It also provides liquidity to a deceased owner's family and assures the remaining owners that they will be able to continue the business without interference from the family of the deceased owner. Buy/sell agreements also offer estate planning benefits by establishing a value for the business prior to an owner's death.

Common methods for determining the purchase price under a buy/sell agreement include (1) establishing a fixed price in the contract, (2) requiring an independent appraisal, or (3) specifying a formula such as a percentage of book value. Events that trigger a buy/sell agreement are specified by the owners in the contract. Generally, buy/sell agreements are triggered by any circumstance that might cause an owner to dispose of an ownership interest—such as death, disability, bankruptcy or retirement.

The best time to establish a buy/sell agreement is now, before a problem develops. Please give us a call if you would like to discuss the merits of a buy/sell agreement for your business.

The tax benefits of selling rather than trading in business vehicles

Although a vehicle's value typically drops fairly rapidly, the tax rules limit the amount of annual depreciation that can be claimed on most cars and light trucks. Thus, when it's time to replace a vehicle used in your business, it's not unusual for its tax basis to be higher than its value.

If you trade the vehicle in on a new one, the undepreciated basis of the old vehicle simply tacks onto the basis of the new one (even though this extra basis generally doesn't generate any additional current depreciation because of the annual depreciation limits). However, if you sell the old vehicle rather than trade it in, any excess of basis over the vehicle's value can be claimed as a deductible loss to the extent of your business use of the vehicle.

For example, if you sell a vehicle with an adjusted basis of $20,000 for $12,000, you'll get an immediate write-off of $8,000 ($20,000 - $12,000). If you trade in the vehicle rather than selling it, the $20,000 adjusted basis is added to the new vehicle's depreciable basis and, thanks to the annual depreciation limits, it may be years before any tax deductions are realized.

Write off damaged or obsolete inventory items

Inventory is normally valued for tax purposes at cost or the lower of cost or market value. Regardless of which of these methods is used, the end-of-the-year inventory should be reviewed to detect obsolete or damaged items. The carrying cost of any such items may be written down to their probable selling price (net of selling expenses). (This rule does not apply to businesses that use the last in, first out (LIFO) method because LIFO does not distinguish between goods that have been written down and those that have not.)

To claim a deduction for a write-down of obsolete inventory, you are not required to scrap the item. However, in a period ending not later than 30 days after the inventory date, the item must be actually offered for sale at the price to which the inventory is reduced.

Taking advantage of Flexible Spending Accounts (FSAs)

If your employer has a health care and/or dependent care FSA, before year end you must specify how much of your 2015 salary to convert into tax-free contributions to the plan. You can then take tax-free withdrawals next year to reimburse yourself for out-of-pocket medical and dental expenses and qualifying dependent care costs. Watch out, though, FSAs are "use-it-or-lose-it" accounts — you don't want to set aside more than what you'll likely have in qualifying expenses for the year.

Married couples who both have access to FSAs will also need to decide whose FSA to use. If one spouse's salary is likely to be higher than what's known as the FICA wage limit (which is $117,000 for 2014, and will likely be somewhat higher next year) and the other spouse's will be less, the one with the lesser salary should fund as much of the couple's FSA needs as possible. The reason is that the 6.2% Social Security tax levy for 2015 is set to stop at the FICA wage limit (and doesn't apply at all to money put into an FSA). Thus, for example, if one spouse earns $125,000 and the other $40,000, and they want to collectively set aside $5,000 in their FSAs, they can save $310 (6.2% of $5,000) by having the full amount taken from the lower-paid spouse's salary vs. having 100% taken from the other one's wages. Of course, either way, the couple will also save approximately $1,400 in income and Medicare taxes because of the FSAs.

If you currently have a health care FSA, make sure you drain it by incurring eligible expenses before the deadline for this year. Otherwise, you'll lose the remaining balance. It's not that hard to drum some things up: new glasses or contacts, dental work you've been putting off, or prescriptions that can be filled early.

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Questions about something you've read? Call us!

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