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Year-End Tax Planning Checklist

Appropriate Checklists for Year-End Tax Planning

What are appropriate checklists for year-end tax planning?

Tax planners often develop checklists to guide taxpayers toward year-end strategies that might help reduce taxes. Typically, suggestions are grouped into several different categories, such as "Filing Status" or "Employee Matters," for ease of reading. When year-end approaches, it might be wise to review each suggestion under the categories that may apply to you.

Filing status and dependents

- If you're married (or will be married by the end of the year), you should compare the tax liability for yourself and your spouse based on all filing statuses that you might select. Compare the results when you file jointly and when you file married separately. Determine which results in lower overall taxation.
- If you and several other people financially support someone but none of you individually qualifies to claim the individual as a dependent, you should consider making an agreement with all of the other parties to ensure that at least one of you can claim the individual as a dependent. Certain tax benefits may be available if you can claim an individual as a dependent.

Family tax planning

- Determine whether you can shift income to family members who are in lower tax brackets in order to minimize overall taxes. ***Tip:*** *The kiddie tax rules apply to: (1) those under age 18, (2) those age 18 whose earned income doesn't exceed one-half of their support, and (3) those age 19 to 23 who are full-time students and whose earned income doesn't exceed one-half of their support.*
- Consider making gifts of up to $15,000 per person federal gift tax free under the annual gift tax exclusion. Use assets that are likely to appreciate significantly for optimum income tax savings.
- Take advantage of tax credits for higher education costs if you're eligible to do so. These may include the American Opportunity (Hope) credit and the Lifetime Learning credit. Note that these credits are based on the tax year rather than the academic year. Therefore, you should try to bunch expenses to maximize the education credits.

Tip: *If you have qualified student loans (and meet all necessary requirements), you may be entitled to take a deduction for the interest you paid during the year. The maximum amount you can deduct is $2,500.*

Employee matters

- Self-employed individuals (who generally use the cash method of accounting) can defer income by delaying the billing of clients until next year. You may also be able to defer a bonus until the following year.
- Use installment sale agreements to spread out any potential capital gains among future taxable periods.

Business income and expenses

- Accelerate expenses (such as repair work and the purchase of supplies and equipment) in the current year to lower your tax bill.
- Increase your employer's withholding of state and federal taxes to help you avoid exposure to estimated tax underpayment penalties.
- Pay last-quarter taxes before December 31 rather than waiting until January 15.
- If you have significant business losses this year, it may be possible for you to apply them to the prior year's returns to receive a net operating loss carryback refund. If you had significant income in prior years, you should maximize the current year's losses by deferring income if possible.
- In certain circumstances, it may be possible for the full cost of last-minute purchases of equipment to be deducted currently by taking advantage of Section 179 deductions.
- Generally, you are able to make a contribution to your retirement plan at any time up to the due date (plus extensions) for filing a given year's tax return.

Financial investments

- Pay attention to the changes in the capital gains tax rates for individuals and try to sell only assets held for more than 12 months.
- Consider selling stock if you have capital losses this year that you need to offset with capital gain income.
- If you plan to sell some of your investments this year, consider selling the investments that produce the smallest gain.

Personal residence and other real estate

- Make your early January mortgage payment (i.e., payment due no later than January 15 of next year) in December so that you can deduct the accrued interest for the current year that is paid in the current year.
- If you want to sell your principal residence, make sure you qualify to exclude all or part of the capital gain from the sale from federal income tax. If you meet the requirements, you can exclude up to $250,000 ($500,000 for married couples filing jointly). Generally, you can exclude the gain only if you used the home as your principal residence for at least two out of the five years preceding the sale. In addition, you can generally use this exemption only once every two years. However, even if you don't meet these tests, you may still be able to qualify for a reduced exclusion if you meet the relevant conditions.
- Consider structuring the sale of investment property as an installment sale in order to defer gains to later years.
- Maximize the tax benefits you derive from your second home by modifying your personal use of the property in accordance with applicable tax guidelines.

Retirement contributions

- Make the maximum deductible contribution to your IRA. Try to avoid premature IRA payouts to avoid the 10 percent early withdrawal penalty (unless you meet an exception). Contribute the full amount to a spousal IRA, if possible. If you meet all of the requirements, you may be able to deduct annual contributions of $6,000 to your traditional IRA and $6,000 to your spouse's IRA. You may be able to contribute and deduct more if you're at least age 50.
- Set up a retirement plan for yourself, if you are a self-employed taxpayer.
- Set up an IRA for each of your children who have earned income.
- Minimize the income tax on Social Security benefits by lowering your income below the applicable threshold.

Charitable donations

- Make a charitable donation (cash or even old clothes) before the end of the year. Remember to keep all of your receipts from the recipient charity.
- Use appreciated stock rather than cash when contributing to charities. This may help you avoid income tax on the built-in gain in the stock, while at the same time maximizing your charitable deduction.
- Use a credit card to make contributions in order to ensure that they can be deducted in the current year.

Adoption and medical expenses

- Take advantage of the adoption tax credit for any qualified adoption expenses you paid. In 2020, you may be able to claim up to $14,300 (up from $14,080 in 2019) per eligible child (including children with special needs) as a tax credit. The credit begins to phase out once your modified AGI exceeds $214,520 (up from $211,160 in 2019), and it's completely eliminated when your modified AGI reaches $254,520 (up from $251,160 in 2019).
- Maximize the use of itemized medical expenses by bunching such expenses in the same year, to the extent possible, in order to meet the threshold percentage of your AGI.

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