INDEPENDENT WEALTH MANAGEMENT

Lower Your Tax Bill With Year-End Planning

By planning ahead and taking advantage of these time-proven tax strategies before year-end, you may be able to lessen your tax bite come April 15.

As the end of the year draws near, the last thing anyone wants to think about is taxes. But if you are looking for ways to minimize your tax bill, there's no better time for tax planning than *before* year-end. That's because there are a number of tax-smart strategies you can implement now that will reduce your tax bill come April 15.

As the year begins to draw to a close, consider how the following strategies might help to lower your taxes.

Put Losses to Work

If you expect to realize either short- or long-term capital gains, the IRS allows you to offset these gains with capital losses. Short-term gains (gains on assets held less than a year) are taxed at ordinary rates, which range from 10% to 39.6%, and can be offset with short-term losses. Long-term gains (gains on assets held longer than a year) are taxed at a top rate of 20% and can be reduced by long-term capital losses.[1] To the extent that losses exceed gains, you can deduct up to $3,000 in capital losses against ordinary income on that year's tax return and carry forward any unused losses for future years.

Given these rules, there are several actions you should consider:

- Avoid short-term capital gains when possible, as these are taxed at higher ordinary rates. Unless you have short-term capital losses to offset them, try holding the assets for at least one year.
- Take a good look at your portfolio before year-end and estimate your gains and losses. Some investments, such as mutual funds, incur trading gains or losses that must be reported on your tax return and are difficult to predict. But most capital gains and losses will be triggered by the sale of the asset, which you usually control. Are there some winners that have enjoyed a run and are ripe for selling? Are there losers you would be better off liquidating? The important point is to cover as much of the gains with losses as you can, thereby minimizing your capital gains tax.
- Consider taking capital losses before capital gains, since unused losses may be carried forward for use in future years, while gains must be taken in the year they are realized.

When evaluating whether or not to sell a given investment, keep in mind that a few down periods don't mean you should sell simply to realize a loss. Stocks in particular are long-term investments subject to ups and downs. Likewise, a healthy unrealized gain does not necessarily mean an investment is ripe for selling. Remember that past performance is no indication of future results; it is expectations for future performance that count. Moreover, taxes should only be one consideration in any decision to sell or hold an investment.

Unearned Income Tax

A 3.8% tax on "unearned" income went into effect in 2013, effectively increasing the top rate on most long-term capital gains to 23.8%. The tax applies to "net investment income," which includes interest, dividends, royalties, annuities, rents, and other passive activity income, among other items. Importantly, "net investment income" does *not* include distributions from IRAs or qualified retirement plans, annuity payouts, or income from tax-exempt municipal bonds. In general, the new tax applies to single taxpayers with a modified adjusted gross income (MAGI) of $200,000 or more and to those who are married and filing jointly with a MAGI of $250,000 or more.

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IRAs: Contribute, Distribute, or Convert

One simple way of reducing your taxes is to contribute to a traditional IRA, if you are eligible. Contributions are made on a pretax basis, so they reduce your taxable income. Contribution limits for the 2016 tax year -- which may be made until April 17, 2017 -- are $5,500 per individual and $6,500 for those aged 50 or older. Note that deductibility phases out above certain income levels, depending upon your filing status and if you or your spouse are covered by an employer-sponsored retirement plan.

An important year-end consideration for older IRA holders is whether or not they have taken required minimum distributions. The IRS requires account holders aged 70½ or older to withdraw specified amounts from their traditional IRA each year. These amounts vary depending on your age, increasing as you grow older. If you have not taken the required distributions in a given year, the IRS will impose a 50% tax on the shortfall. So make sure you make the required minimums for the year by year-end.

Another consideration for traditional IRA holders is whether to convert to a Roth IRA. If you expect your tax rate to increase in the future -- either because of rising earnings or a change in tax laws -- converting to a Roth may make sense, especially if you are still a ways from retirement. You will have to pay taxes on any pretax contributions and earnings in your traditional IRA for the year you convert, but withdrawals from a Roth IRA are tax free and penalty free as long as you're at least 59½ and the converted account has been open at least five years. If you have a nondeductible traditional IRA (i.e., your contributions did not qualify for a tax deduction because your income was not within the parameters established by the IRS), investment earnings will be taxed but the amount of your contributions will not. The conversion will not trigger the 10% additional tax for early withdrawals.

Regardless of what Congress does in the future, there are many steps you can take today to help lighten your tax burden. Work with a financial professional and tax advisor to see what you can do now to reduce your tax bill in April.

Source/Disclaimer:

[1]Under certain circumstances, the IRS permits you to offset long-term gains with net short-term capital losses. See IRS Publication 550, *Investment Income and Expenses*.

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