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Client Update

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Tips on Year-End Tax Planning

The conventional wisdom for year-end tax preparation is that you should accelerate deductions and defer income. But that isn't always true. Some taxpayers are in a state of transition; they may have been unemployed in 2004 and will therefore have a higher tax rate in 2005. Others, those who have lots of children, incentive stock options, legal settlements, or big home-equity bills, may find themselves subject to the alternative minimum tax (AMT). People in those categories will want to **accelerate income and defer deductions**. If you are not familiar with AMT, talk to your accountant.

Assuming you are in the typical, "defer income, accelerate deductions" category, here are a few things for you to do before the end of the year:

1. *Maximize your retirement plan contributions.* According to Chris Jarski, a CPA, individuals should "Make sure your retirement accounts are established and make sure you maximize your funding into them. Allow the IRS to help underwrite your retirement with the tax deduction you receive." If you are self-employed, make sure you set up your account before December 31. If you have a 401(k), try to increase your contributions before year's end.
2. *Give it away.* Clean out your closets and your checkbook. Make your old clothing donations, your church payments, and your charitable

contributions now instead of waiting until the year's end.

3. *Sell investments that are showing losses.* You can use those losses to offset gains and to offset up to \$3,000 in regular income. You can't buy the same security for 30 days without violating IRS rules, but you can buy something similar.
4. *Make your January mortgage payment in December.* That's right, if you pay January's interest before the end of this year, you can deduct it on this year's tax return. Of course, you will reduce your interest expense for next year.
5. *Keep good records.* When you keep good records, you typically keep more of the money you earn. This will also reduce the temptation to fudge on your taxes.

Finally, don't wait until the last week of the year to do all of this. A little preparation and planning now will allow you to enjoy the holiday season.

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Get Priorities in Order When It's Time to Start Withdrawals

Prioritizing the order of withdrawals in retirement can help minimize your tax bite. The general rule is to take money first from regular investment accounts and let tax-deferred assets accumulate. Postpone Social Security payments, because payouts increase each year you wait, until age 70. And tax tax-free Roth IRAs last, because they can be passed along to kids.



Ready for the caveat? Throw in your tax rate and early withdrawal and required distribution rules, and these guidelines could go out the door. “The withdrawal issues are going to make the accumulation issues look like child’s play,” says Alicia Munnell, director of the Center for Retirement Research at Boston College.

The lowdown on when it makes sense to tweak the withdrawal hierarchy: If your brokerage accounts hold only assets taxed at the long-term capital gains rate – currently at a maximum of 15% – consider withdrawing first from tax-deferred accounts, says Robert Carlson, author of *The New Rules of Retirement: Strategies for a Secure Future*.

Assets in IRAs and 401(k) plans accumulate tax-deferred and then are hit with ordinary-income rates, currently at a maximum of 35%, when they come out. The idea is to let the assets that will be taxed at the lowest rate accumulate for the longest time.

Another reason not to tap taxable accounts if you don’t need to: When appreciated stock in these vehicles pass to heirs after you die, they get a “step up” in value. That means taxes are paid only on the stock’s gains after your heirs get it.

<http://biz.yahoo.com>

Introducing the Roth 401(k)

Beginning in January, employers may offer a new retirement savings account, the Roth 401(k). The account is appealing for high earners because there are no income limits like those that forbid some workers from using Roth IRAs. Like the Roth IRA, the Roth 401(k) provides no up-front tax break, but all the money you withdraw in retirement is tax free as long as the account has been open for at least five years and the account owner is at least 59 ½ years old. In 2006, you can contribute up to \$15,000 to a 401(k) – whether a regular or Roth account or a

combination of the two. The maximum is \$20,000 if you’ll be 50 or older by year-end.

Kiplinger’s Personal Finance Advisor, October 2005

What is the Saver’s Credit?

You may be eligible to grab a credit on your tax return simply by saving your money. If you qualify for the Saver’s Credit, you can get a credit for up to half of what you contribute to your IRA or other eligible retirement plan.

A quick reminder: a tax “credit” means you reduce your tax liability dollar for dollar, versus a “deduction”, which reduces your income subject to tax.

Up to \$2000 of your annual contribution is eligible for the Saver’s Credit. How much of the Saver’s Credit you are eligible for (and whether you get any of it) depends on your filing status and adjusted gross income (AGI). For this purpose AGI includes excluded foreign income.

Those eligible for a credit of 50% of their contributions are joint filers with up to \$30,000 AGI, head of household filers with up to \$22,000 AGI, and other filers with no more than \$15,000 AGI.

On the other end of the spectrum are those who may not qualify for the credit. You are not eligible for the Saver’s

Credit if you file a joint return and have an AGI of more than \$50,000. The same goes for those heads of households whose AGI is more than \$37,500, and other filers whose AGI is more than \$25,000.

The Saver’s Credit creates yet another reason to invest in an IRA. If you haven’t started an IRA yet or made a contribution to your already established IRA or retirement plan this year, don’t fret, there’s still time. You have until April 15, 2006, to contribute to a retirement plan for the 2005 tax year.

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