Independent Investor

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It Pays to Plan Ahead: 2013 Year-End Tax Planning

As 2013 draws to a close, the last thing anyone wants to think about is taxes. But if you are looking for potential ways to minimize your tax bill, there's no better time for planning than *before* year-end. And, with the higher rates put in place with the passage of the American Taxpayer Relief Act of 2012, being tax efficient is more important than ever.

Consider how the following strategies might help you to lower your taxes.

Put Losses to Work

Since stock and bond performance tends to differ throughout the year, there is a chance that your target asset allocation has shifted, potentially exposing you to more risk than you originally intended.[1] That is why now is a good time to review your portfolio for gains and losses and make adjustments as needed.

The IRS allows you to offset investment gains with losses, a practice sometimes referred to as tax-loss harvesting. Short-term gains (gains on assets held less than a year) are taxed at ordinary income tax rates, which now 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.[2] 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 may want to 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.

- 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.

- Consider sell or hold decisions carefully. 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.

Maximize the Power of Tax Deferral

Year-end is a good time to reevaluate employer-sponsored benefits, such as qualified retirement plans that offer tax deferral and typically allow participants to make contributions on a pre-tax basis, thereby lowering current taxable income. If you have not already done so, you may still have time to "max out" your 2013 contribution of $17,500—with an additional $5,500 in "catch up" contributions if you are aged 50 or older.[3]

Once you have contributed the maximum to your employer plan, consider doing the same with any IRA accounts you may have. Depending on your situation, you may be able to deduct all or a portion of this year's contribution ($5,500 with an additional $1,000 in catch-up contributions) from your 2013 tax bill.

Another important year-end consideration for older IRA holders is whether or not they have taken their required minimum distribution (RMD). Starting at age 70½, the IRS requires account holders to withdraw specified amounts from their traditional IRAs each year. . If you have not taken the required distribution in a given year, the IRS will impose a 50% tax on the shortfall. So make sure you take any required distributions by December 31.

Income Shifting Through Gift Gifting

Year-end is also a time to make gifts to children, grandchildren and charities. The annual gift tax exclusion is currently $14,000 per individual ($28,000 for spouses combined). This technique works particularly well for individuals or couples who want to give away significant assets in a relatively short time frame. For instance, assuming you and your spouse have one child who is married and two grandchildren, you could give away $112,000 this year--$14,000 from each of you to each family member—without affecting your lifetime gift tax or estate tax exemptions. Over time, these annual gifts could help to shift considerable assets out of your taxable estate.

Another time-sensitive gifting strategy involves making a charitable gift from an IRA. The tax law passed in January 2013 granted IRA holders who are at least 70½ years old an extension (through December 31, 2013) for making contributions of up to $100,000 directly from an IRA to a charity of choice without having to treat the withdrawal as taxable income. While the gift is not tax deductible, if done properly it does help fulfill your RMD for the year.

If you act fast, there is still time to reduce your tax bill before the books close on 2013. Contact your financial professional and tax advisor for assistance.

[1]Investing in stocks involves risks, including the loss of principal. Bonds are subject to interest rate risk if sold prior to maturity. Bonds are subject to availability and change in price. Asset allocation does not assure a profit or protect against a loss.

[2]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*.

[3]These are government maximums. Your employer may impose lower limits. Rules vary, so check with your benefits administrator to see if there is still time to increase your deferral rate for 2013.

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