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In Tax Planning, Planning is the Operative Word

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Once upon a time, tax planning meant making a few end-of-year adjustments to reduce taxes due in April. Today, planning means taking a much broader and more proactive view to take advantage of a wide range of tax situations.

For taxpayers, there's no need (or hope) to know all the intricacies of the tax code. The help of a professional is essential. What the taxpayer can provide, however, is a complete and candid description of his or her current circumstances, projections for the future and long-term goals. Your tax professional needs to know about the following situations to help you make appropriate plans going forward.

My income is going up. With the passage of the American Taxpayer Relief Act in early 2013, high earners face higher rates and phase-outs of some deductions. If you're expecting a spike in income, it may make sense to defer income or accelerate deductions. These moves would affect your adjusted gross income, which is the basis for most of the relevant tax rules. Some provisions of the new law kick in at $450,000 for married taxpayers, while previously implemented provisions of the Affordable Care Act apply to couples making $250,000 or more. If you're approaching these levels, after credits and deductions, it may be worth a look.

My income is going down. Are you retiring early? Or maybe starting a new business and taking little or no salary? A decline in income can provide benefits beyond simply being in a lower tax bracket. For instance, you may be able to pay no tax on capital gain — yes, zero percent — if you are in the 15 percent tax rate or lower ($72,500 for couples). That means not harvesting capital losses like most taxpayers do, but capital gains. Selling appreciated securities can provide a tax-free cash flow, or if a cash flow isn't needed, securities can be sold and repurchased to raise the cost basis to current prices, lowering future tax liability.

I have additional income or deductions. A jump in income or deductions, such as high state income taxes or real estate taxes, may subject you to an alternative minimum tax (AMT) for the first time. This is a parallel tax system meant to prevent big deductions and credits from reducing taxes to a too-low level. The AMT is a separate tax calculation that has an exemption amount that phases out as your income increases. If it produces a result higher than the regular tax, you'll pay the AMT amount.

You may be able to stay out of an AMT by deferring income or delaying state income or property tax payments into the next calendar year, or making other adjustments that lower your adjusted gross income.

I want to make things easier after I'm gone. The goal estate planners pursue is to ensure that all our assets are distributed as we wish while our tax losses are limited. In many cases, there's a benefit to starting this process long before death. For instance, if you plan to leave significant amounts to children or others, you can start with gifts while you are still alive, to as many recipients as you wish, up to $14,000 per year per person. This approach reduces the size of your taxable estate and puts money in the hands of those who may need it more now. And while not reducing the taxable estate, it still might make sense to transfer more than $14,000 each year and use some of the lifetime exclusion, which is currently $5.25 million.

We normally think of the traditional-versus-Roth IRA question to be one of tax treatment. But there's another side to that decision: Whom do you want to have the proceeds after your death, and when? A non-spousal beneficiary of your Roth can fully distribute the balance after your death, without paying taxes on the proceeds as long as the five-year holding period was met. With a traditional IRA, the beneficiary would be paying tax on the distributions, so this could trigger a big tax bill. If you will have a taxable estate, converting a traditional IRA to a Roth IRA and paying the tax during your lifetime and further reducing your estate by the amount of the tax paid might be a viable option.

I want to make a difference. The tax benefits related to charitable contributions are a bonus on top of the difference they can make in education, medical research, the arts and other fields. Depending how the contributions are made and where they come from, you may be able to make your contribution go further. For instance, if you are older than 70, you can make your required minimum distributions directly from your IRA to a charity and avoid taxation of the distribution. (But it must be paid directly from the IRA to the charity; if you take possession, the benefit is lost.)

SPEAK FREELY

These are just a few situations that merit attention and discussion with your financial team. Of course, all of these possibilities come with numerous exceptions, limits and constraints. The key idea is that your tax advisor needs to know your current situation, your financial expectations for coming years and the goals you have for your assets. Two people with very similar situations but different plans for the future may need very different tax plans.

Keep candid dialogues going with your investment advisor and tax professional. It can only help in the ongoing challenge of tax planning.

About Scott Brown, Managing Member, Wealth Management Group, LLC, Dover, Del.

Scott Brown, CPA/PFS is managing member of Wealth Management Group, LLC, an independent member of the BAM ALLIANCE.

Scott has been involved in the financial service industry for more than 20 years. He spent many years as managing partner for Raymond F. Book & Associates before becoming the managing member of Wealth Management Group. Scott uses the combination of tax knowledge and wealth management experience to help clients achieve their financial goals.

Scott holds a bachelor's degree in accounting from Wilmington University.

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