

“Last minute” year-end tax-saving moves for individuals

Practice Alert

Although there is only one week left to go before the year ends, it's not too late to implement some planning moves that can improve a client's tax situation for 2011 and beyond. This *Practice Alert* reviews some actions that clients can take before Dec. 31 to improve their overall tax picture.

Make HSA contributions. Under Code Sec. 223(b)(8)(A), a calendar year taxpayer who became an eligible individual under the health savings account (HSA) rules on December 1, 2011, is treated as having been an eligible individual for the entire year. Thus, he may make a full year's deductible-above-the-line contribution for 2011. That means a deduction of \$3,050 for individual coverage, and \$6,150 for family coverage (those age 55 or older get an additional \$1,000 catch-up amount).

RIA Research References: See FTC 2d/FIN ¶ H-1350 et seq.; United States Tax Reporter ¶ 2234; TaxDesk ¶ 289,100 et seq.

Nail down losses on stock while substantially preserving your investment position. A taxpayer may have experienced paper losses on stock in a particular company or industry in which he wants to keep an investment. He may be able to realize his losses on the shares for tax purposes and still retain the same, or approximately the same, investment position. This can be accomplished by selling the shares and buying other shares in the same company or another company in the same industry to replace them. There are several ways this can be done. For example, an individual can sell the original holding, then buy back the same securities at least 31 days later.

RIA Research References: See FTC 2d/FIN ¶ I-3900 et seq.; United States Tax Reporter ¶ 10,914; TaxDesk ¶ 227,000 et seq.

Convert a regular IRA to a Roth IRA. Individuals who believe a Roth IRA is a better strategy than a traditional IRA, and want to remain in the market for the long term, should convert traditional-IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA if eligible to do so. Note, however, that such a conversion shouldn't be done without considering the individual's overall tax situation. Even at depressed market levels, a 2011 rollover or conversion still will increase a taxpayer's AGI, possibly propelling him or her into a higher tax bracket, and diluting (or eliminating) those tax breaks that have AGI-based phaseouts or “floors.”

RIA Research References: See FTC 2d/FIN ¶ H-12290.20; United States Tax Reporter ¶ 408A4; TaxDesk ¶ 283,316.

Recharacterizing a traditional IRA to Roth IRA conversion. If an individual converted assets in a traditional IRA to a Roth IRA earlier in the year, the assets in the Roth IRA account may have declined in value. If things are left things as-is, the

individual will wind up paying a higher tax than is necessary. However, there's a way to back out of the transaction, namely by recharacterizing the rollover or conversion. This involves transferring the converted amount (plus earnings, or minus losses) from the Roth IRA back to a traditional IRA via a trustee-to-trustee transfer. The individual can later reconvert to a Roth IRA.

RIA Research References: See FTC 2d/FIN ¶ H-12290.22; United States Tax Reporter ¶ 408A4; TaxDesk ¶ 283,328.

Accelerate deductible contributions. Individuals should keep in mind that charitable contributions and medical expenses are deductible when charged to their credit card accounts (e.g., in 2011) rather than when they pay the card company (e.g., in 2012).

RIA Research References: See FTC 2d/FIN ¶ G-2436; United States Tax Reporter ¶ 4614.01; TaxDesk ¶ 441,407.

Solve an underpayment problem. An individual who expects to be underwithheld for 2011 should consider asking his employer—if it's not too late to do so—to increase income tax withholding before year-end. Generally, income tax withheld by an employer from an employee's wages or salary is treated as paid in equal amounts on each of the four installment due dates. Thus, if an employee asks his employer to withhold additional amounts for the rest of the year, the penalty can be retroactively eliminated. This is because the heavy year-end withholding will be treated as paid equally over the four installment due dates.

Outside-the-box solution. An individual can take an eligible rollover distribution from a qualified retirement plan before the end of 2011 if he is facing a penalty for underpayment of estimated tax and the increased withholding option is unavailable or won't sufficiently address the problem. Income tax will be withheld from the distribution at a 20% rate and will be applied toward the taxes owed for 2011. He can then timely roll over the gross amount of the distribution, as increased by the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2011, but the withheld tax will be applied pro rata over the full 2011 tax year to reduce previous underpayments of estimated tax.

RIA Research References: See FTC 2d/FIN ¶ S-5248; United States Tax Reporter ¶ 66,544.02; TaxDesk ¶ 571,342.