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Year’s end is a critical time for financial planning

Aaron Skloff's December IT'S YOUR BUSINESS column

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Q: With the end of the year quickly approaching, what are some important tax and financial planning measures we can take to reduce our taxes and improve our financial position?

The problem: Year-end financial oversights and mistakes.

With so many gifts to purchase and holiday parties to attend, it is easy to forget important year-end tax and financial planning measures that can save you taxes or bear benefits for years to come.

The solution: Take action in the next two weeks.

Many tax and financial planning deadlines are based on a calendar cycle — do them after Dec. 31 and lose the benefit for that year. Outlined below are some of the most common oversights and mistakes to avoid before the year comes to a close.

Not contributing to your 401(k) or 403(b): Not only do you build your retirement nest egg, but you also gain a tax break by contributing to your employer’s retirement plan. Better yet, many employers will match your contributions. Unfortunately, there is a cap on contributions each year. For 2007, it is $15,500 for those under the age of 50 and $20,500 for those aged 50 and over. Once you maximize your contribution you cannot make additional contributions to make up for under-contributing in previous years.

Not timing capital gains and losses: Capital gains and losses are classified as either short-term (less than one year) or long-term (more than one year). Long-term losses can only offset long-term gains, and vice versa.

Selling investments, like stocks or mutual funds, you have held for more than one year generates a 15 percent capital gains tax rate. Realizing a gain on investments held for less than one year could generate a 35 percent tax rate. Review your portfolio to maximize your gains and losses. Do not forget your gains are reported on your New Jersey state income tax filing.

Leaving money in your flexible spending account: Many employees take advantage of their employer-provided pre-tax flexible spending account (FSA). Unfortunately, many employees leave balances in their accounts at year-end instead of spending them down.

Many FSAs have a “use it or lose it” policy, and you could be wasting your hard-earned savings by not spending down your balance. Make sure you pay your child’s day care bill and fill your medical cabinet before Dec. 31.

Paying the alternative minimum tax: The AMT is rampant in New Jersey. Instead of prepaying your state income taxes and real estate taxes, pay them when they are due. Instead of exercising your incentive stock options early, exercise them when they are closer to their expiration date. Each of these measures could eliminate or mitigate your AMT exposure.

Forgetting to take your required minimum distribution: Also know as RMD, required minimum distributions are necessary on traditional IRA accounts once you turn 70 ½ years old. If you have a 401(k) or 403(b) from a former employer and you are at least 70 ½ years old, RMD applies as well. Forget to take your RMD and you can be subject to a 50 percent tax penalty.

Forgetting to fund your 529: For 2007, the maximum contribution per person, per beneficiary to a 529 higher education savings plan is $12,000. There is a special five-year one time pull-forward rule. Like a 401(k) or 403(b), once you maximize your contribution you cannot make additional contributions to make up for under-contributing in previous years.

Plan assets of up to $25,000 in the New Jersey 529 plan won’t be included in determining a beneficiary’s eligibility to receive financial aid awarded by the state of New Jersey.

Action steps: Reduce your taxes and improve your financial position.

Do not leave money on the table, pay more taxes then you need to pay, or fail to meet your goals of funding a college education or a comfortable retirement. Avoiding the oversights listed above can reap benefits for years to come.

Aaron Skloff is an accredited investment fiduciary, chartered financial analyst, and holds a masters of business administration. He is the chief executive officer of Skloff Financial Group, a Berkeley Heights-based registered investment advisory firm. The firm specializes in financial planning and investment management services for high net worth individuals and benefits for small- to middle-sized companies. He can be contacted at (908) 464-3060.