



I DO MY OWN TAXES EVERY APRIL. WHY DO I NEED HELP?

Did you know that 92 percent of all Americans fail to take advantage of substantial tax deductions? Even if you have a simple return, tax planning can reduce your tax bite. Tax planning should be a long-term, year-round process. Many strategies overlooked during the tax year cannot be salvaged in the waning days of December or when you're hunched over your tax return in April. Decisions you make today can affect your tax bill next year—and beyond.

Life events also can alter your overall financial picture, and often your tax consequences. Children are born, people change jobs or receive promotions, marriages and divorces occur, parents die, investments succeed and fail. Tax laws change nearly every year and can have a profound effect on tax planning. You need to work with someone who keeps abreast of these changes.

A CERTIFIED FINANCIAL PLANNER™ professional can help you develop and implement careful tax-planning strategies that can save you thousands of dollars over the years. Money saved by reducing your taxes can be directed toward your personal goals: children's education, a comfortable retirement, investments, vacations, and building and preserving your estate.



SHOULD I USE A TAX SPECIALIST?

A competent accountant, tax attorney or tax preparer are certainly good resources to use. Tax planning, as with any sound investment or retirement program, needs to be examined in light of your overall financial picture. Therefore, your financial planner may work in tandem with your tax specialist.

It's easy to let the tax tail wag the dog. Tax planning strategies should fit your overall personal financial desires and needs, not dictate them.



WHAT ARE SOME EXAMPLES OF LONG-TERM TAX-PLANNING STRATEGIES?

Certain deductions can be taken only if their total exceeds a minimum threshold. For example, medical expenses must exceed 7.5 percent of adjusted gross income (AGI) and miscellaneous expenses must exceed 2 percent of AGI before you can begin deducting the excess. These thresholds are often difficult to exceed in a single year, but by bunching expenses every other year (such as elective surgery) you might exceed these floors and take advantage of the deductions. Such a strategy takes advance planning.

If you are on the edge of a tax bracket, a change in income or itemized deductions could affect your tax rate. If you expect your tax rate to remain constant or decline in the future, you may want to defer income (such as bonuses or the selling of certain investments) while accelerating itemized deductions such as charitable contributions or state income tax payments. If you expect your tax rate to be higher next year, you may want to do the opposite. Again, this takes advance planning.

Since you can no longer deduct interest for installment purchases such as a new car or television set, you may want to consider consolidating loans by taking out a home equity loan, which in most cases is tax deductible. Be cautious, however, because you are putting your home at risk with increased debt.



WHAT OTHER OVERLOOKED WAYS CAN I USE TO REDUCE MY TAXES?

- You might consider gifting appreciated property to charity or employing your children if you own a business.
- One of the most overlooked yet effective tax-reduction strategies is to maximize use of company savings plans, such as 401(k), 403(b), or profit-sharing plans. Basically, these plans allow you to put money into a tax-deferred investment account, meaning you won't pay taxes on it until you withdraw the money (usually at retirement). These plans offer several advantages:
- Tax-deferred investments grow faster than comparable-earning taxable accounts. If you are in a combined 30 percent federal and state tax bracket, for example, every \$100 you put into a tax-qualified corporate plan means you have \$30 more working for you than if you'd received the money in your monthly check, paid taxes on it, and put the remainder into a savings account or taxable investment.
- Some employers contribute to their employees' qualified accounts, enhancing earnings even more. Many of these plans are self-directed, meaning you have some flexibility in how you want your funds invested. Instead of using only traditional lower-earning fixed-income investments, you can put some of your money into higher-earning vehicles such as stock mutual funds. The combination of tax deferral and compounding higher return can build retirement funds dramatically over time.
- Your employer also may offer other tax-advantaged benefit programs, such as flexible spending accounts, in which you can set aside funds out of your paycheck free of tax for such expenses as child care or medical care.



I'M SELF-EMPLOYED. WHAT TAX BREAKS ARE AVAILABLE TO ME?

Individual retirement accounts (IRAs), or Keogh plans and simplified employee pension plans (SEPs), which are similar to company savings plans, are great long-term ways for the self-employed to reduce taxes. You can also take deductions if you have a home office. A planner can review the legal form of your business. Sole proprietorships, partnerships and corporations each have different tax consequences.



ARE THERE ANY TAX SHELTERS LEFT?

Congress has eliminated many tax shelters, which is probably to the good for most investors since many highly touted shelters with large tax write-offs often turned out to be bad investments. Nonetheless, tax shelters do remain. You may consider the following:

- One of the best we mentioned earlier: tax-deferred retirement accounts such as 401(k), 403(b), and Keogh plans.
- Tax-free municipal bonds can be free of federal, state and local taxes, though some only escape federal tax.
- Another tax shelter is annuities. These are contracts with insurance companies in which you pay them money and they promise income payments in return, often for life, depending on the type of annuity. However, their "guarantee" to pay depends on their ability to pay claims. It is not federally guaranteed.
- The earnings inside 529 savings plans and Coverdell education savings accounts are never taxed as long as they are used to pay for qualified college expenses.
- Series EE bonds can compound tax-deferred for up to 30 years. Depending on your income level, the earnings can escape taxation if they are used for qualified college expenses.
- If you invest in historic housing, you can receive a tax credit for money you put into improving the property.



WHY NOT JUST PUT ALL MY MONEY INTO TAX-ADVANTAGED INVESTMENTS?

Investments should be chosen for their overall return, level of risk, and their appropriateness for

your investment portfolio rather than for tax issues alone. For example, a CFP® professional can help compare the yields of a tax-free investment versus a higher-earning taxable investment. Sometimes it's actually better in the long run to pay taxes, depending on your tax bracket, risk tolerance and investment objectives.

Furthermore, tax-free investments have risks. Municipal bonds fluctuate in value if you sell them early. If you want to get out of your annuity contract early because it's performing poorly, the company may assess a steep withdrawal penalty. The government also can penalize you if you withdraw the funds before age 59 1/2. Historic housing carries investment risk like any real estate property.



SHOULD I SHIFT INCOME-PRODUCING ASSETS INTO MY CHILDREN'S NAME?

It can be beneficial under some circumstances. For a child younger than 14, the first \$750 in unearned income is tax free, the next \$750 is taxed at the child's rate. Any income above that is taxed at the parent's rate. For children 14 and over, the first \$750 is free of tax and all unearned income thereafter is taxed at the child's rate. For example, you could transfer stock or mutual fund shares to a child about to enter college, then have your child sell them, saving you taxes.

CAUTION: If you transfer assets into your child's name, you are giving up control of those assets. Your child may decide to use the assets to buy a car instead of go to college. Also, shifting assets to your child can actually reduce the amount of financial aid for which your child may be eligible. This is an example of when saving taxes may not necessarily be the best strategy. Your CFP professional can help you decide if the trade-offs are worth it.



SHOULD I WORRY ABOUT THE AMT?

The alternative minimum tax (AMT) is a separate tax system created to ensure that wealthier taxpayers who pay little or no regular income tax because of heavy deductions and other tax strategies will pay at least some tax. However, in the wake of tax law changes, more and more average taxpayers will become subject to the AMT. Some of the strategies mentioned earlier for reducing regular income tax, such as gifting appreciated property to a charity or accelerating itemized deductions, may actually increase your AMT liability. Again, careful planning with your CFP® professional can minimize your overall tax bite.



SHOULD I HAVE A PROFESSIONAL PREPARE MY TAX RETURN?

If you can do basic math and you have a simple return, with income from wages and perhaps a few investments, you probably can do the return yourself. If you have business interests, are self-employed, have multiple sources of income and complex investments, have unusual deductions, or have a high income, you probably should seek professional advice. A good tax adviser can more than pay for his or her fee. Remember, however, even if you have someone else do your tax return, you should examine the return carefully. You are the one liable for the taxes.



CAN A CFP PROFESSIONAL PREPARE MY TAX RETURN?

An increasing number of CFP professionals prepare returns. Since they are already familiar with their clients' financial situations, this makes for an excellent combination. If your CFP professional does not prepare returns, he or she can recommend a return specialist, such as an accountant or enrolled agent, to handle the return.



WHY IS A CFP PROFESSIONAL QUALIFIED TO HELP ME?

Not everyone who calls themselves a financial planner is a CERTIFIED FINANCIAL PLANNER™ professional. To obtain the CFP certification, a person must study and demonstrate competency in six areas vital to comprehensive financial planning, including insurance, retirement, investments and estate planning by successfully completing the CFP™ Certification Examination. The emphasis of the CFP educational program is on the interrelationship of the financial areas and the need for an objective analysis of a client's circumstances and goals. The CFP professional must also meet educational, work experience and ethical standards to maintain the right to use the CFP mark.

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