FERRIS FINANCIAL, LLC
HELPING YOU PLAN, PROTECT & PROSPER

Overview

Income tax planning is an important aspect of your overall financial picture. The following tables provide a list of some of the items contained in an individual income tax return and a brief discussion of ways to reduce income taxes and address other gaps.

1040		
Line(s)	**Category**	**Opportunity**
6(b), 6(c)	Spouse and Dependents	Are your current net assets enough to support your family if your life were to end unexpectedly?
7	Wages, salaries, tips, etc.	In light of the higher (39.6%) top income tax bracket and the 0.9% Medicare surtax on earned income above certain levels[1], it may be more important than ever to find ways to reduce your taxable income, e.g., contributions to retirement plans, deductions for charitable contributions, etc. Moreover, because your estate is likely increasing, it may be time to evaluate your estate plan.
8, 9	Interest and dividends	The increase in the tax rate on qualified dividends from 15% to 20% and the 3.8% Medicare surtax applicable to net investment income[2] has increased the relative advantage of tax-favored investments.
11, 31(a)	Alimony	Are payments to or from an ex-spouse secured upon the death of the payor?
12	Business income	A qualified retirement plan can enable you to save a significant amount of federal income tax each year. In some cases, it may be possible to allocate more contributions to your own account and less to accounts for your employees.

[1] $200,000 for a single taxpayer and $250,000 for a married couple filing jointly.
[2] Above the thresholds mentioned in footnote 1.

1040		
Line(s)	**Category**	**Opportunity**
13	Capital gain	The higher rate on qualified dividends also applies to long-term capital gains and the higher top income tax bracket applies to short-term capital gains.
15(b)	IRA distributions	Distributions can be channeled to a life insurance policy designed to provide income tax-free death proceeds. This can enable your beneficiaries to avoid income taxes on distributions from inherited IRAs.
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc.	What is the source of this income? • Rental real estate –Where real estate represents a sizable portion of your net worth, your retirement and estate planning may involve the need to create liquidity. Also, because out-of-state realty can cause your estate to be re-probated in multiple states, additional planning may be needed to minimize administrative costs. • Partnership/S Corporation – Developing a sound and proven exit strategy can help you ensure that you can walk away from the business at the time of your choosing and that you and your family will benefit from your success, regardless of when your departure occurs. • Trusts – Income not distributed from trusts may be taxed at higher rates than distributed income.
20(b)	Social Security benefits	Taxes on Social Security income can be reduced by reducing Modified Adjusted Gross Income, i.e., positioning other assets into tax-deferred accounts.
25	Heath Savings Account	Contributions to a qualified health savings account may be deductible depending on your health insurance plan.
28	Self-Employed plans	If you're self-employed, contributions to an employer-sponsored retirement plan generally can be made on your behalf.
32	IRA deduction	To the extent contributions to IRAs (or Roth IRAs) are limited by the federally imposed limits or, in the case of deductible IRA contributions, by your income, other products can provide tax deferral and potentially tax-free income.
33	Student Loan Interest	Depending on your income level, student loan interest may be deductible.
40	Itemized deductions	See "Schedule A" (below).
45	Alternative minimum tax	Certain otherwise tax-free income or tax-deductible expenses may be added back to calculate taxable income.
63	Total tax	How do you feel about this? Is it important to reduce this figure?
64	Income tax withheld	Withholding too much may result in substantial opportunity costs. While care must be taken to avoid withholding too little (which can result in underpayment penalties and interest charges), careful analysis of your personal tax situation can help you find money you can use for other purposes.
75	Amount you overpaid	These funds can be put toward your retirement, estate, and other financial goals.

Schedule A		
Line(s)	**Category**	**Opportunity**
1	Medical and dental expenses	A portion of long-term care insurance premiums may be includable as a medical expense. For business owners, there may be advantages to coordinating this planning with your company, especially C corporations.
6	Real estate taxes	Property in other states may increase estate settlement costs because your will may have to be probated in those other states. It may be possible to reduce your taxable estate by transferring a residence, e.g., a second home, to a trust for future generations.
10	Home mortgage interest	Income from renting a second home for part of the year or a recently refinanced home may free up cash that can be directed toward other financial needs, e.g., retirement savings, family protection, etc.
19	Gifts to charity	Life insurance can create a relatively large charitable endowment or replace other assets transferred to charity.

General Suggestions

Pre-retirement. For most taxpayers, the best way to reduce current income is to establish and fund a qualified retirement plan or IRA. After deductible retirement plan contributions have been maximized, the next best thing from an investment standpoint is to find ways to defer investment income. Roth contributions may be appropriate where a current tax deduction is not as important as future tax-free income. Additionally, certain assets—such as non-dividend paying (growth) stocks, tax-efficient mutual funds and exchange-traded funds, deferred annuities, and life insurance—can defer income tax. With regard to investment income that cannot be repositioned or earned income, when possible, time the recognition of income to stay below the next highest tax bracket.

Post-retirement. As prior to retirement, the general rule is to defer taxes as long as possible. Compensation should be deferred. Depending on other factors, incentive stock options should be held. On the other hand, it may be advisable to take distributions from qualified and nonqualified sources so as to fill up tax brackets. Moreover, continued tax deferral in a retirement account—until distributions are required at age 70½—must be weighed against the 'tax trap' that awaits beneficiaries who do not receive a stepped-up cost basis and who must pay ordinary income taxes on distributions. Retirees who find themselves in a lower tax bracket than during their working years may find a Roth conversion appropriate. Income, i.e., taxes, will be accelerated but subsequent withdrawals will be tax free. If you hold company stock in your retirement plan and wish to continue to hold the stock, you can elect "NUA" (Net Unrealized Appreciation) treatment whereby the stock would be distributed from the plan, ordinary income tax would be paid only on the cost basis of the stock, and capital gain would be deferred until the stock is disposed of. Taxes on gains from business or investment property outside of a qualified plan can be deferred by means of a like-kind exchange.[3] Where property will be sold, an installment sale can defer gain and the corresponding taxes over a number of years.

[3] Internal Revenue Code §1031.

Deductions. As with income, deductions should be timed so as to maximize their usefulness. This may involve a 'bunching' strategy where deductions can be high in one year when they can be itemized and low in the next year when the standard deduction can be used. Renting your vacation home may entitle you to take deductions on maintenance and repair costs, utilities, taxes, etc., that would otherwise be non-deductible. Well-documented charitable contributions, investment expenses (in excess of 2% of adjusted gross income), and debts that are unlikely to be repaid may also provide noteworthy deductions.

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