Tips for Year-End Tax Savings

by Stuart Lerman

Recent changes in tax laws have reduced and even eliminated many tax breaks. But there are still a few things you can do before the end of the year to keep your tax bill as low as possible. Here are some tax-saving strategies you can use between now and December 31. As always, to determine the proper tax consequences of your specific situation, you should consult with an experienced tax professional who is familiar with your business and personal taxes.

Business Taxes

No change in income tax rates is currently scheduled for '95, which usually means that the best strategy is to defer taxable income into 1995 and to accelerate deductible expenses into 1994.

Expense your equipment. Generally, you can't deduct the purchase price of business equipment: The law requires you to depreciate it over its estimated useful life. You can, however, expense up to $17,500 in equipment purchases per year. Your deductions will be limited if you have less than $17,500 of business income or if your equipment purchases for the year exceed $200,000.

One exception is for a new automobile purchased in 1994: The maximum deduction will be $2,960 regardless of the cost of the vehicle. The limitations on the deductions for leased vehicles, however, are not as severe. So in many circumstances, it makes sense to lease vehicles as opposed to purchasing them, and reap the substantial tax write-off. (Be sure to consult an accountant about the many other variables affecting lease/buy decisions.)

Increase retirement plan contributions. The maximum contribution an individual can make to an Individual Retirement Account, or IRA, is $2,000 ($2,250 for a spousal IRA). If you are self-employed, however, you can contribute substantially more — at least $20,000 more to a business-sponsored plan. Two common choices are a Keogh and a Self-Employed Plan (SEP). A Keogh must be set up by December 31, 1994, but a SEP can be set up any time before the due date of your tax return (including extensions). With either plan, you have until the due date of your 1994 tax return (including extensions) to actually make the contribution.

Shift Cash-Basis Income

If you're using cash-basis accounting, you can postpone income to the next year as long as the income isn't actually or "constructively" received this year. Income is constructively received if there is no substantial restriction on the manner and time of payment.

Therefore, you many want to do your billing as late as possible in the month of December so that you won't receive payment in December and won't be taxed on the income this year. But remember, the tax law doesn't allow you to turn your back on money available to you this year by simply delaying deposit until next year.

Accelerate expenses. Cash-basis businesses can also deduct expenses when the amounts are actually paid. There are several ways this can help with this year's taxes.

- Pay in 1994 all bills already received for expenses rather than waiting to make payment in 1995.
- Incur and pay expenses in 1994 that would normally be incurred and paid in 1995. For example, you may replenish office supplies or have needed repairs made early.
- Pay a business insurance premium for a policy period that overlaps portions of this year and next year. Some courts have allowed a deduction for the full amount in the year of payment, but only when the taxpayer has consistently made full payments.
- Pay a full year's rent. Some courts have held that cash-basis businesses

may deduct the whole amount in the year of payment, even though most of the rental period is in the following year.

Accrual-Basis Businesses

For a business using accrual-basis accounting, delaying receipt of cash won't defer taxable income. As soon as the right to income is fixed and the amount can be reasonably determined, it is taxable. Because of this, the only way an accrual-basis taxpayer can postpone income (other than by the installment method) is to defer the actual right to receive payment for the services or merchandise.

Postponing income. One way to do this would be to postpone the completion of a job to 1995 so that the right to income arises in 1995, even though most of the actual work is done in 1994. However, certain rules apply to long term contracts for manufacturing, building, and construction of property, which generally force the taxpayer to recognize income on a percentage-of-completion method. Be sure to consult your tax adviser about this.

Another way to defer income is to postpone the closing of a sale, or to delay settlement of a pending dispute over an item of income, until next year.

Deducting bonuses. An accrual-basis corporation can take a deduction in 1994 for bonuses paid in 1995, if the following conditions are met:

- The employees don't own more than 50% in the value of the corporation's stock.
- The bonus is properly accrued on the books before the end of the current tax year.
- The bonus is actually paid within the first 2 1/2 months following the tax year.

Order early. Another way to shift expenses into the current year is to order and take delivery of expense items before 1995. Similarly, you can have services performed for you before 1995. You get the deduction for the expenses that you have incurred in 1994, yet the actual payment may be made in 1995.

Individual Taxes

There are several strategies for reducing your personal taxes as well.

Contribute to an IRA. Deductible IRA contributions are still a wise investment: Not only do you get an immediate tax deduction, the earnings in the account accumulate tax-free. The IRA contribution may not be deductible, however, if you have a retirement plan at work (the earnings are still tax-free).

Pay off personal debt. Credit card interest and other interest on personal debt is no longer deductible. Consider paying off your personal debt by taking out a home equity loan. Interest on the money you borrow against your home may be deductible when used to pay off consumer debt, as long as the loans don't exceed $100,000.

You can do the same thing when you buy a car. Rather than finance through a bank or car company, you can use a home equity loan to purchase the vehicle, and the interest then becomes tax deductible.

Prepay state and local taxes. If you expect to owe state income taxes in April, you can accelerate your federal deduction by prepaying a reasonable estimate by December 31, 1994. Also, if you've been billed for real estate taxes, but haven't paid them yet, do so by December 31, 1994, to get the deduction.

Combine deductions. Medical expenses and miscellaneous itemized deductions are deductible only if they exceed a certain percentage of adjusted gross income (7 1/2% for medical expenses, 2% for miscellaneous deductions). One way to increase your chances of getting a deduction is to combine two years' worth of expenses into one year.

Credit cards. Use credit card charges to accelerate deductible expenses. The IRS says that charitable contributions and medical expenses are deductible as of the date your account is charged rather than when you pay the credit card company. ■

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