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Year-End Tax Planning: 10 Things to Keep in Mind

The window of opportunity for many tax-saving moves closes on December 31. So set aside some time to evaluate your tax situation now, while there's still time to affect your bottom line for the current tax year. With that in mind, here are 10 things to consider as the curtain closes on 2011.

1. Deferring income to 2012 means postponing taxes

Consider opportunities you might have to defer income to 2012. You might be able to delay a year-end bonus, for example. If you're able to push what would have been 2011 income into 2012, you may be able to put off paying income tax on the deferred dollars until next year.

2. Paying deductible expenses sooner may help you in 2011

Does it make sense for you to accelerate deductions into 2011? If you itemize deductions, it might help your 2011 bottom line to pay deductible expenses like medical costs, qualifying interest, and state and local taxes before the end of the year, instead of waiting until 2012.

3. Income tax rates to remain the same in 2012

The same six federal income tax rates that apply in 2011 will apply in 2012. So, depending upon your income, you'll fall into either the 10%, 15%, 25%, 28%, 33%, or 35% rate bracket. And, as in 2011, long-term capital gains and qualifying dividends will continue to be taxed at a maximum rate of 15% in 2012; and if you're in the 10% or 15% tax rate brackets, a special 0% tax rate will generally continue to apply.

4. Is AMT a factor?

If you're subject to the alternative minimum tax (AMT), special rules apply. For example, the AMT rules can effectively disallow a number of itemized deductions, making it a potentially significant consideration when it comes to year-end planning. You're more likely to be subject to AMT if you claim a large number of personal exemptions, deductible medical expenses, state and local taxes, and miscellaneous itemized deductions. If you've been subject to the AMT in the past, or think that you might be for 2011, you'll want to make sure that you understand how the AMT rules might affect you.

5. IRA and retirement plan contributions

Employer-sponsored retirement plans like 401(k) plans and traditional IRAs (if you qualify to make deductible contributions) present an opportunity to contribute funds on a pre-tax basis, reducing your 2011 taxable income. Contributions that you make to a Roth IRA (assuming you meet the income requirements) aren't deductible, so there's no tax benefit for 2011--they're still worth considering, though, because qualified distributions are free from federal income tax. The window to make 2011 contributions to your employer plan closes at the end of the year, but you can generally make 2011 contributions to your IRA up to April 17, 2012.

6. Special distribution requirements at age 70½

Once you reach age 70½, you're generally required to start taking required minimum distributions (RMDs) from any traditional IRAs or employer-sponsored retirement plans you own. It's important to make withdrawals by the date required--the end of the year for most individuals. The penalty is steep for failing to do so: 50% of the amount that should have been distributed. Barring additional legislation, 2011 will be the last year to take advantage of a popular provision allowing individuals age 70½ or older to make qualified charitable distributions of up to $100,000 from an IRA directly to a qualified charity (these charitable distributions are excluded from your income, and count toward satisfying any RMDs that you would otherwise have to take from your IRA for 2011).

7. Depreciation and expense limits to drop for business owners and the self-employed

If you're a small business owner or a self-employed individual, you're allowed a first-year depreciation deduction of 100% of the cost of qualifying property acquired and placed in service during 2011; this "bonus" first-year additional depreciation deduction will drop to 50% for property acquired and placed in service during 2012. For 2011, the maximum amount that can be expensed under IRC Section 179 is $500,000, but in 2012 the limit will drop to $139,000.

8. Last chance to deduct energy-efficient home improvements

This is the last year you'll be able to claim a credit for energy-efficient improvements you make to your home (up to 10% of the cost of qualifying property). Improvements can include a qualifying roof, windows, skylights, exterior doors, and insulation materials. Specific credit amounts may also be available for the purchase of energy-efficient furnaces and hot water boilers. However, there's a lifetime credit cap of $500 ($200 for windows). So, if you've claimed the credit in the past--in one or more years since 2005--you're only entitled to the difference between the current cap and the amount you've claimed in the past.

9. Other expiring provisions

Barring additional legislation, this is the last year that you'll be able to elect to deduct state and local general sales tax in lieu of state and local income tax, if you itemize deductions. This also will be the last year for both the above-the-line deduction for qualified higher education expenses, and the above-the-line deduction for up to $250 of out-of-pocket classroom expenses paid by education professionals.

10. Get help

Making effective year-end moves requires a solid understanding of the rules that are in effect for both 2011 and 2012. It also requires a comprehensive grasp of your overall financial situation. A financial professional can help you evaluate potential opportunities, and can keep you apprised of any last-minute legislative changes.