Current issues in tax planning

[Economics](), [Tax]()

It is the intention of every taxpayer to minimize their tax liabilities whenever possible. This is where the concept of tax planning comes into focus. Tax planning is the evaluation of tax position and its outcomes by considering for example the business decisions and strategies with the objective of reducing the tax burden in the current period or in the long term. It is simply analysing one’s business or personal activities and formulating plans that are able to minimize the tax liability.

Individuals and businesses can utilize tax planning in areas like accounting methods employed (cash and accrual concepts), stock valuation methods (LIFO, FIFO), capital expenditures, insurance contributions, pension contributions and even tax-deferred investments. (Ref) Tax planning can also be used ion transactions involving mergers and acquisitions. In mergers and acquisitions, tax planning can help in evaluating the amount tax savings and risks incurred and thereby reducing costly mergers or acquisitions. (Busenhart, Slide 3) Tax planning process In undertaking a tax planning, several factors are considered, key among these are

Tax returns It is important that a taxpayer identifies the tax form that best suits their needs in terms of financial and legal conditions. Filing the correct form will ensure that the IRS works on the taxpayers tax returns in a timely and accurate manner (Perez) Some of the widely used tax forms for filing income tax for individuals are 1040EZ, 1040 A and the 1040. Tax filing status An individual can have many filing options and therefore it is paramount that one understands the rules and regulations of each status because each has benefits and drawbacks as well.

The individual income tax filing status can be single, jointly married, separately married, head of household and qualifying widow(er) with dependant. These statuses call for different tax rates. Single status is only determinable at the last day of the year. One has to be single or divorced or separated at that date. This status, however, leads to higher rates faster compared to other (360 Degrees of Financial Literacy). Joint filing status is possible if married, separated but still married or separated but not finalized.

This status results in joint income, exemptions, credit and deductions. It also has many tax credits e. g. child/dependent care, hope credit, adoption expense credit and lifetime learning credit. Qualifying widow(er) status can lead to the most deductions (standard) available to joint tax returns. To file on this status, one must have not remarried before the year end, have a qualifying dependant child, provide more than half of upkeep cost, qualified to file a joint return for the year the spouse died or the spouse died during the last 2 years (360 Degrees of Financial Literacy).

Filing married but separate returns can be appropriate if one is personally responsible for the tax however the tax liability is joint with some credits like child/dependant care tax credits. Head of household status offers lower tax rates with much lower standard deductions. Head of household should be unmarried at year end, maintain a household for spouse/child, household must be home, must be US citizen or resident alien for whole year, and provide more than half of upkeep cost (360 Degrees of Financial Literacy). Tax planning for income As seen earlier, the main objective of tax planning is to reduce the tax liability.

There are several ways in which a taxpayer can minimize his/her tax burden. An example of income planning is deferring part of the taxes on income by e. g. contributing to a 401(k) plan which leads to payment of tax only on withdrawal hence benefiting from growth during its tax deferral period. Tax shifting to persons with lower tax rates is also another way of planning on income. This income shifting can be the form of gifts which are not taxable up to $ 12, 0 00 a year not considering the kiddie tax rules (360 Degrees of Financial Literacy). A person can exploit the deductions being offered to their advantage.

This can be done by using all deducting possible in a timely and tax beneficial manner. Deductions in which you can control over should be fully exploited i. e. by e. g. utilizing all deductions during the current tax year instead of the following year if a person expects his/her tax bracket rate to be lower next year. Another way could be claiming standards or itemized deductions. Itemized deductions will not be allowed after attaining maximum adjusted gross income. Individuals can also reduce their taxes by planning on their investments this could be through investing in tax exempt assets like series EE bonds.

These bonds are used foreducation. Municipal bonds interest is also not taxable under state federal or local authority. Generally it is important to focus on the tax implication of each investment. Capital gains usually attract lower tax rates compared to other sources of income. One can also reduce the amount of tax payable by timing on the sale of securities. If a tax payer expects lower tax rates in the future, then, he/ she can opt to sell the assets at the time when the tax rates are lower. Taxpayers can also plan on their marginal tax rates at the end of the year.

Year-end planning is the evaluation of one’s income timing so as to minimize taxes. Examples of year-end planning can be deductions and incomes like bonuses received at the end of the year. If the income tax bracket is higher currently then claim all deductions now and request the bonuses to be paid when the rates are lower. Deduction and credits Taxable income is arrived at by adjusting the adjusted gross income will deductions and exemptions. Itemized deductions lead to lower taxable incomes. Tax credits on the other hand also reduce taxable income.

Examples of tax credits that a taxpayer can claim are college expenses, retirement contributions and adoption costs. Tax deadlines and extensions Late filing of tax returns can lead to penalties. Therefore it is wise that taxpayer knows his/her tax deadline in order to avoid being fined and penalized (Perez). Tax payers can also request for tax filing date extensions from the IRS and not tax payment. Tax extensions application is done using the automatic extension form 4868, which is submitted to the IRS with the tax amount due.

Late filing of returns without extensions will lead penalties and therefore it is wise to ensure that if a tax payer contemplates that the return filling will be late, then, he/she should request for an extension. Payment options The payments of tax or filing a tax return can be done through the following ways; calling IRS toll free number, through the internet, credit card or the electronic tax payment system(Perez) . The payment system chosen should be less costly and efficient so as to avoid penalties due to late payment or filing of returns. Current tax planning issues

There are several changes to the laws in the county over the recent past. This, therefore, calls for new tax planning measures to capture the new changes in tax laws. The new tax laws should be exploited by the tax payer in /her planning thus minimizing the tax payable. The new tax changes are as below; Alternative minimum tax (AMT) It is another method of calculating taxes. In this method, the taxpayer is the one who pays the excess of the normal tax or the minimum tax. The minimum tax and normal tax are usually not the same, this, therefore leads to a difference, which is calculated using the IRS form 6251.

The calculated minimum tax can be higher than the normal tax. The difference is then included in form 1040 (which is used to file normal tax) as an additional minimum tax. Alternative minimum tax is calculated in a different way as compared to the regular tax. It does not follow the income addition and subtraction of deduction credits and exemptions to arrive to taxable income, then, tax is calculated. Under AMT standard deduction, personal exemptions or certain itemized deductions are not deductible. Exempt tax under regular tax is taxed under AMT. The result of this is that the AMT is higher than the regular normal tax calculations.

Examples of deductions not allowed under ATM include itemized deductions (local taxes, medical expenses, miscellaneous expenses) accelerated depreciation mortgage interest on home equity debt, foreign tax credits, investment expenses, passive incomes and losses, net operating loss deduction, tax exempt interest from private activity bonds and exercising incentive stock options. ATM exempted amount for 2008 under the single and head of household status is $ 33, 750, $ 45, 000 for married people and qualifying widow(er) and $ 22, 500 for married people filling separately.

The rates for 2008 are 26% for first $ 175, 000 with extra amounts taxed at 28% It is challenging to find ways of reducing taxes under but a tax payer can evaluate state tax withholding so as not to overpay or underpay hence ensuring ATM adjustments are lower. A taxpayer can e. g. pay property taxes when due and not prepay and whenever a tax payer exercises in incentive stock options, he/she should dispose them the same year-this is because not disposing off will make the income taxable under ATM (Perez). Records for charity

Charitable donations regardless of the form i. e. cash property of whatever values are to be documented using receipts since 2007. The documentation can take the form of bank statements, credit card statements, and checks whether cancelled or not. The records should show the names of the charity, date and their written acceptance of the donations, which should be in good condition. Therefore taxpayers should be careful to document any charity they make to ensure that they can deduct it from their taxable incomes. Mortgage insurance premiums

Since March 2007 up to the end of 2010 mortgage insurance premiums are deductible and therefore this presents the taxpayer with another form of tax savings. Qualifying insurance is that from private mortgage insurance companies, federal housing administration, rural housing administration and veterans’ administration. Tax relief for fore closures and mortgage restructuring Loss of homes by way of foreclosures or mortgage restructuring can qualify for a tax relief. Mortgage on homes are nowadays exempt from tax on written off mortgages Tax benefits that will expire in 2007

Some tax benefits are usually granted by the IRS for a limited specified duration after which they are no longer claimable. Example of these benefits that ended in 2007 includes the following; Classroom expenses deductions, tuition fees deduction, deduction for mortgage insurance premiums, excluding charitable. IRA distributions form income, itemized deduction for sales taxes, non business energy, tax credit, first time home buyer credit (DC), and election to include non combat pay for purposes of calculating the earned income credit (Perez).

The taxpayer should therefore keep track of all the benefits that expire in order to take advantage of them before they expire. Benefits credits and deductions that a taxpayer can utilize The adoption credit and adoption assistance program credits have been increased for the 2007 tax year. A taxpayer can utilize these tax credits if he/she plans to adopt thus reducing the taxable income. These credits however, are not claimed by taxpayers whose adjusted gross income is more than $210, 820 per year for the year 2007 (IRS).

AMTs exemption amounts have also increased; both for a child under 18 years of age and for the different filing statuses. Under the AMT also, persons providing shelter to people who host their homes under hurricane Katrina used to be allowed exemptions. These exemptions however are no longer allowable under AMT (IRS). Other tax credits that a taxpayer could use in his/her tax planning, strategies are earned income amount for additional child, tax credit, earned income credit, education savings bond, healthsavings account, hope and lifetime learning credits which have all increased (IRS).

Recently the Congress passed an Act on the economic stimulus payment. This law could provide a taxpayer with payments of up to $1200 (joint return) with additional amounts per qualifying child. The payment will only be received if a taxpayer files the 2007 return and for those with earned income, social security benefits, and certain veteran payments amounting to $3000 (FairMark Press Inc). This payment however, is reduced or phased out completely if a taxpayer adjusted gross income is more than $75000 (single), $150, 000 (joint filing).

Also taxpayers filing forms 1040 NR, 1040 NR-EZ, 1040 PR or 1040 SS and claimed as a dependent cannot receive this payment (IRS). Conclusion It is important that a taxpayer understands the consequences of claiming a deduction on his other deduction. This is because a single deduction could jeopardize the claiming of other deductions thereby leading to higher taxes. Dollar for dollar tax credits are more beneficial than tax deductions, above the line deductions are also more beneficial than below the line deductions because they reduce the adjusted gross income, it is better to claim exemptions e. g.

Personal/dependency than itemized deductions on below the line deductions merely because itemized deductions do not result in tax savings and it is also important to pay attention to the marginal tax rate because different rates have different deductions (Jackson). Therefore taxpayers are advised to seek expert advice on some of the tax issues in order to receive maximum tax savings. Works Cited: Jackson, George. Individual Income Tax Planning: A Conceptual Approach. The New York State Society of CPAs.

Elizabeth City. Elizabeth State University N. C. 2008 Perez, William. What's New for 2007 Taxes? About. com. 3/3/2008 http://taxes. about. com/od/2007taxes/a/whatsnew2007. htm IRS. Tax Law Changes for Individuals. IRS. gov. 3/3/2008 < http://search. irs. gov/> FairMark Press Inc. Tax News from FairMark. Thomas Kaye. 3/3/2008 360 Degrees of Financial Literacy. General Tax Planning. AICPA. 3/3/2008

Busenhart, Martin. Importance of Tax Planning. 3/3/2008 http://www. calalumni. ch/pages/hane/hanswiss/presentations/cane180999/index. htm Wiener, Leonard. " How to Keep One Step Ahead: Hot Tips for Turning an Annual Chore into Many Happy Returns. " U. S. News and World Report. March 9, 1998. Wiener, Leonard. " Tricks to Trim Taxes. " U. S. News and World Report. December 7, 1998. Ellentuck, Albert B. Laventhol and Horwath Small Business Tax Planning Guide. New York: Avon Books, 1988.