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Plan now to ease next year's tax bill

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For most people, tax season ended on April 15, unless they were in counties affected by floods earlier this year.

Even in flood-affected counties, May 19 was the filing deadline.

Before you file away the 2007 return, tax experts say you can ease next year's burden by taking a hard look at your tax situation now.

First, look at the size of your refund.

Sean McKenzie, a tax manager at Brown Smith Wallace LLC, an accounting firm in Creve Coeur, says some clients get excited when they hear they're getting a big refund.

"In most cases, what they're doing is giving the government an interest-free loan," he said. "It means their paychecks are smaller throughout the year."

McKenzie recommends that you adjust your withholding downward if your refund is more than a few hundred dollars.

"We'd like to see every taxpayer at zero," he said.

Your employer's payroll department can help with that. (It also can help if you need to increase withholding.)

If you've been able to live on a smaller paycheck all year, consider increasing your contribution to a retirement account when you cut the withholding. Before-tax contributions often don't hurt as much, and they can reduce your taxable income this year.

Even if you didn't get a refund, chances are you can put more into retirement accounts, said Don Kukla, a principal with Moneta Group in Clayton. Employees can put as much as \$15,500 in a defined-contribution plan, or \$20,500 if they're over 50.

"It's easier to put by a little at the time as opposed to all at once at the end of the year," Kukla said.

If you think you need a refund to jump-start emergency savings, try setting up a direct deposit from your paycheck to a savings account instead. That way you can collect interest on the money all year rather than letting the government use your money.

Investors who have highly appreciated stock should consider whether it makes sense to sell while the capital-gains tax rate is still at 15 percent, McKenzie said. Most people expect tax rates to change, depending on which party wins this fall's elections. No matter what happens, the lower rate probably won't last beyond 2010.

Kukla says he advises against selling simply to pay the lower tax rate. A small change in financial markets could offset the rate change. But if the money is needed to pay for college or you need to reallocate your portfolio, selling now could make sense.

Another alternative is to donate appreciated stock to a charity. The charity gets the full value of the stock, but you don't have to pay capital gains on the appreciation.

While you're looking at your portfolio, Kukla says you should consider putting more tax-efficient investments outside of retirement plans. For example, it makes more sense to have a passive investment like an index fund in taxable accounts and a more actively managed fund in retirement accounts.

Kukla said some investors are using donor-advised funds to simplify giving stock or mutual funds to charities. The fund itself is considered a charity, so you get the deduction when you transfer assets to the fund. You can recommend grants from the fund to charities you want to support. The charity gets a check rather than a few shares of stock that can be costly to sell.

However, there are limits on the kinds of grants a donor-advised fund will make. Recipients must be a qualified charity, and the donor can't get any goods or services in exchange for the grant. In addition, many funds have minimum initial deposits and fees that can make them less attractive for smaller contributions.

McKenzie said self-employed individuals may find that 2008 is a good year to invest in equipment used in their businesses. Up to \$250,000 in equipment can be expensed this year. You have to have enough income to offset the expense, and you lose a future depreciation expense.

Most people have a few tax deductions sitting in their closets or basements, McKenzie said. Clothing, furniture and other items in good condition can be donated and their value used as a tax deduction. Donors should make sure they get a receipt, and document the value of the items.

"The more proof that you have to substantiate your donation, the better it is for the IRS," McKenzie said.

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