



Investment Insights

Kevin Kennedy

Five tax tips to save money in 2005

July 29, 2005

The ink has just dried, and the wounds are still healing from last year's tax returns. With the sting of the IRS still fresh in our minds, now is the time to take action to lessen the amount you'll owe next year.

Proactively looking at your tax situation gives you the best chance to take steps to save money come next April. As the year winds down, your ability to reduce your taxes diminishes, so don't wait until next year to look for ways to help yourself.

Here are five tips to help you keep more money in your pocket this year:

1. **Maximize your retirement contributions.** Contribution limits have been increasing every year for the past few years, and most company-sponsored plans (401(k)s, 403(b)s, etc) now allow up to \$14,000 in annual contributions. If you're over 50, you can also make a "catch-up" contribution of an additional \$4,000. This is one of the few ways to reduce your taxable income, so make sure you're taking full advantage of the opportunity by putting away as much as you can afford. Contributions typically come from your paychecks, so act now to adjust the amount withheld between now and year-end.
2. **Take losses on investments.** Although we're a few years removed from the dramatic decline in the stock market, many investors are still holding investments that are worth less than the original purchase price. By selling off the losers in your portfolio, you can use the capital losses generated to offset any capital gains you have this year on anything you've sold (including real estate, a business, or other investments). If you have more realized losses than gains, you can use an additional \$3,000 of the losses to offset your taxable income. Remember, you must sell the investment before the end of the year to claim the loss.
3. **Consolidate your debt using home equity.** Interest on credit card debt and auto loans typically isn't tax-deductible. However, interest paid on home equity debt is typically tax-deductible. If you have debt, look into using equity in your home to pay that debt off. Not only is the interest you'll pay likely to be deductible, but also the interest rate on home equity loans is typically much lower than other types of loans. Home equity loans are easy to establish, and often have low or no fees involved. Check with your current

mortgage company to see what they can offer, then shop around on the web and through local lenders to find the best deal.

4. Review your tax withholding or quarterly estimated taxes. This is particularly important if you've had a significant change in your income versus last year. There's nothing worse than finding out a few weeks before tax time that you owe thousands in additional taxes. If you've had a change in income, realized a big gain on a sale of an asset, had a child, or gotten married, talk to your CPA about how you should adjust your tax payments now to cover the added taxes you'll owe. It's much easier to pay this additional amount over a period of months than it is to come up with the money all at once next April, so check into it now.

5. Watch out for the Alternative Minimum Tax (AMT). The AMT is an evil best explained by your CPA, but suffice it to say, you don't want to fall into this trap. More and more taxpayers each year are subject to the AMT, and although reform is needed, nothing has happened yet. The net result of AMT is a higher (sometimes much higher) tax bill. If you have a lot of itemized deductions or adjustments to your income, you should be especially concerned. Talk to your tax professional now so this doesn't blindside you come April.

Remember, your ability to reduce your taxes exists now through the end of the year. If you were unhappy about the amount you paid in taxes last year, take action while you can to change your situation for this year.

Kevin Kennedy is president of Kevin Kennedy, LLC, a registered investment advisor firm in Alameda. Reach him at 510-748-1898 or Kevin@KevinKennedyLLC.com. Stocks, bonds, and mutual funds involve risk, including loss of principal. Past performance is no guarantee of future results.