



## Two Tax Tips for the End of 2007

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It's hard to believe, but 2008 is swiftly approaching. As the ball in Times Square falls, not only do you lose your last chance of keeping your 2007 resolutions, but you also lose any chance of taking advantage of two tax strategies that may save you thousands of dollars. Intrigued? Let's get started before the countdown begins.

### Should I Be A Convert?

There is a fantastic tax strategy that is available to those who had a financially difficult year. This applies especially to those with large tax write-offs and minimal income. If this describes you, consider converting your traditional IRA to a Roth IRA.

Here is the strategy: Let's assume that in 2006 you made \$225,000 and you have a traditional IRA worth \$130,000. But this year was not very lucrative for you. In fact, your income was only \$55,000. If you have large write-offs, such as a big mortgage, huge property taxes, a big family, maybe an investment property, you might be thinking that you have write-offs going to waste because they are greater than your income. But you almost never waste tax write-offs. (Yes, some people do have more write-offs than income at times, perhaps if you worked in the real estate industry this year.) Let's say you do a preliminary return in December 2007, making certain assumptions, and you find you will have an additional \$30,000 in deductions above your income level. The good news is you pay no tax this year. The better news is you can convert \$30,000 of your traditional IRA to a Roth IRA, pay no penalty and the tax would be offset by your "wasted" deductions.

Let's pause to think about the benefit of this for a minute. First, the money you put into your traditional IRA was put in pretax, meaning you've paid no tax on it to this point. Second, you have now made a partial conversion to a Roth completely tax free. Third, when you reach age 59, you take 100% of the money out of your Roth tax free. You paid zero, nothing, nada! So, you earned the money tax free, it grew tax free, and it was distributed tax free. What a country!

I know what you're thinking. This is too good to be true. Well, it's true, but there are a few limitations. The first is you can only convert your IRA to a Roth if you earn under \$100,000 a year, excluding the amount you are converting to the Roth. This generally is not a big deal since it would be tough to pay no taxes if you earned over \$100,000 this year. Second, the deadline for the Roth conversion is Dec. 31, not April 15 like most IRA contribution deadlines. So if you are going to take advantage of this tax strategy, don't wait.

Just a few more points about this strategy: Watch your Alternative Minimum Tax, or AMT. (We will discuss the AMT in detail below.) This strategy could get dicey if you risk falling under this parallel tax system. Also, converting makes a lot of sense even if your tax bracket gets pushed as high as 15 percent. As an example, instead of converting only the \$30,000 in wasted tax deductions, you could convert \$60,650 and only pay 10-15% in taxes on the dollar amounts above the \$30,000 level. Paying this low level in taxes today to get all appreciation tax free in the future is a very reasonable price. Finally, this is a very powerful

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strategy for young people who worked and then went back to school full-time and are earning little or no money in 2007. Why do they benefit most? The younger you are, the more time you have to accumulate tax-free compounded appreciation. If I convert \$20,000 at the age of 30 and it grows for 35 years at 8%, that \$20,000 now becomes a tax-free \$295,000. That is a lot of tax-free money!

### **That Pesky AMT**

The Alternative Minimum Tax, known as the AMT, was created in 1969 to ensure that a very small number of wealthy people could not use tax breaks or deductions to avoid paying any taxes. In its first year of inception it applied to 200 ultra-wealthy individuals. But it was never indexed to inflation, and every year, the AMT draws in more middle-income taxpayers. This year, some four million people will be subject to the tax.

Congress has been debating for years about how to plug the AMT hole without losing the substantial stream of income it provides. As more and more families fall under this tax, it will become a hot button issue for voters. At this time, Congress has not patched the AMT for 2007, but is working toward a permanent fix for 2008.

So what does that mean for me? If you are likely to fall under the AMT for 2007, consider delaying paying your property and state taxes until January of 2008. By delaying these fourth quarter taxes into the new year, you are playing the odds that congress will remove the AMT and you

will then be eligible to take full advantage of the breaks. Paying them in December of this year only adds more non-deductible taxes to your 2007 return.

The AMT is complex and this strategy may not be right for everyone who fall under it, but it is certainly worth contacting your CPA to investigate your options. But be careful that you understand the grace periods for state and property tax payments. If there's a small penalty, it would more than offset itself if the AMT is repaired or repealed in 2008. But a large penalty may not be worth it. Again, talk to your accountant or financial adviser to weigh your options.

Although these tax strategies may not apply to everyone, those appropriate few will save thousands of dollars. Talk to your accountant, take a more proactive approach to your tax situation, and consider hiring a fee-only financial adviser who can be a liaison between you and your accountant.

Tax strategies are not just for the rich; the more intelligent you are in your treatment of taxes, the more money you will keep in your pocket. And that will truly create a reason for toasting in the New Year.

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