

## 8 TAX SAVINGS FOR YEAR END

The end of the year is fast approaching—and so are several important December 31 financial deadlines. Here are eight financial to do's you may want to carry out before the year ends.

**Convert to a Roth IRA.** With many individual retirement accounts decimated by the bear market, taxpayers may find this the perfect time to convert their traditional individual retirement accounts to a Roth IRA, whose eligible earnings are not taxable upon withdrawal. Because you pay regular income taxes on the money you shift to a Roth, the idea is to convert the smaller pool of assets into a Roth before the assets rebound in value.

Furthermore, taxpayers who couldn't qualify for a Roth conversion before because their income was too high (over \$100,000 for couples and singles) may qualify now if their income is down for the year. You must take the money out of the traditional IRA by December 31. The hitch to all this? It's better to pay for the conversion taxes with money outside of the IRA—potentially difficult in a bear market.

**Open a solo 401(k) plan.** The self-employed and business owners with no full-time paid employees should consider opening a solo 401(k). The 2001 Tax Relief Act made changes to 401(k) plans that make individual 401(k)s cost effective for the first time. Participants can now sock away up to \$41,000 to be put into these accounts in 2002, far more than alternatives such as the SIMPLE IRA or SEP IRA. For 2002, the 401(k) must be opened by this December 31 if you follow the calendar year.

**Begin required retirement plan distributions.** Did you turn 70 1/2 before July 1 this year? You're required to start taking minimum distributions by December 31 from your traditional IRA and employer-sponsored retirement plans (except for the plan of your current employer if you're still working). Technically, you can delay the initial distribution to April 1 of next year, but that means you'd have two required withdrawals next year because all subsequent withdrawals must be completed by December 31. Two minimum distributions in the same year could push you into a higher tax bracket and potentially expose more of your Social Security benefits to tax.

**Pay attention to mutual fund distributions.** You could face the irony of paying taxes on capital gains distributions made by your taxable mutual funds even though the funds lost money for the year. If it's a fund you want to sell anyway, consider selling it before the "ex-dividend" date, which commonly is in November or December. Equally, if not more important, avoid buying into funds before they make their distributions—otherwise you're paying taxes on gains you never earned.

**Review investment gains/losses.** Now is the time to consider selling losing investments to offset those scarce investment profits you made in 2002, or selling profitable investments so they are sheltered by losses you've already realized (and perhaps rebuying those profitable assets if it makes investment sense). If you don't have profits to offset, you can use losses to offset regular income up to \$3,000 (the excess losses carry into future tax years).

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**Bunch deductions.** A time-honored tax strategy is to bunch deductions into a single year. For example, you might accelerate payment of your second installment of property taxes due next spring into this year. The same for next January's payment for estimated taxes. Bunching elective medical expenses such as orthodontia bills also might push your total medical deductions over that often difficult to hurdle 7.5 percent threshold.

**Consider charitable deductions.** Consider increasing charitable contributions in higher income years, or delaying the donation of investments until they regain some of the appreciation they have lost—you'll receive a larger deduction when you do. (Better to donate appreciated assets rather than selling them first.)

**College-bound strategies.** Families may want to postpone into 2003 the receipt of income such as bonuses if they will be applying for financial aid in 2003 (the aid would be calculated on the family's 2002 income). Or they may want to accelerate income from 2003 into 2002 if they anticipate applying for aid in 2004 (which would be based on 2003 income).

Because some of these strategies are complicated and may even conflict with each other, be sure to review them with your financial planner or tax advisor.

October 2002— This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by a local member in good standing of the FPA.

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