The Retirement Maven™ Monthly

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Year-End Tax Planning

As the end of the year approaches, it's time to consider strategies that could help you reduce your tax bill. But most tax tips, suggestions, and strategies are of little practical help without a good understanding of your current tax situation. This is particularly true for year-end planning. You can't know where to go next if you don't know where you are now.

So take a break from the usual fall chores and pull out last year's tax return, along with your current pay stubs and account statements. Doing a few quick projections will help you estimate your present tax situation and identify any glaring issues you'll need to address while there's still time.

When it comes to withholding, don't shortchange yourself

If you project that you'll owe a substantial amount when you file this year's income tax return, ask your employer to increase your federal income tax withholding amounts. If you have both wage and consulting income and are making estimated tax payments, there's an added benefit to doing this: Even though the additional withholding may need to come from your last few paychecks, it's generally treated as having been withheld evenly throughout the year. This may help you avoid paying an estimated tax penalty due to underwithholding.

Of course, if you've significantly overpaid your taxes and estimate you'll be receiving a large refund, you can reduce your withholding accordingly, putting money back in your pocket this year instead of waiting for your refund check to come next year.

Will you suffer the alternative?

Originally intended to prevent the very rich from using "loopholes" to avoid paying taxes, the alternative minimum tax (AMT) now reaches further into the ranks of middle-income taxpayers. The AMT is governed by a separate set of rules that exist in parallel to those for the regular income tax system.

These rules disallow certain deductions that you are allowed to include in computing your regular income tax liability, and treat specific items, such as incentive stock options, differently. As a result, AMT liability may be triggered by such items as:

-The standard deduction
-Large deductions for state, local, personal property, and real estate taxes
-Exercising incentive stock options

So when you sit down to project your taxes, calculate your regular income tax on Form 1040, and then consider your potential AMT liability using Form 6251. If it appears you'll be subject to the AMT, you'll need to take a very different planning approach during the last few months of the year. Even some of the most basic year-end tax planning strategies can have unintended consequences under AMT rules. For example, accelerating certain deductions into this year may prove counterproductive since AMT rules may require you to add them back into your income. If you think AMT is going to be a factor, consider talking to a tax professional about your specific tax situation.

Timing is everything

The last few months of the year may be the time to consider delaying or accelerating income and deductions, taking into consideration the impact on both this year's taxes and next. If you expect to be in a different tax bracket next year, doing so may help you minimize your tax liability. For instance, if you expect to be in a lower tax bracket next year, you might want to postpone income from this year to next so that you will pay tax on it next year instead. At the same time, you may want to accelerate your deductions in order to pay less tax this year.

See disclaimer on final page

To delay income to the following year, you might be able to:

-Defer year-end bonuses
-Defer the sale of capital gain property (or take installment payments rather than a lump-sum payment)
-Postpone receipt of distributions (other than required minimum distributions) from retirement accounts

To accelerate deductions into this year:

-Consider paying medical expenses in December rather than January, if doing so will allow you to qualify for the medical expense deduction
-Prepay deductible interest
-Make alimony payments early
-Make next year's charitable contribution this year

The gifts that give back

If you itemize your deductions, consider donating money or property to charity before the end of the current tax year in order to increase the amount you can deduct on your taxes. As an aside, now is also a good time to consider making noncharitable gifts. You may give up to $15,000 (in 2018, 14,000 in 2017) (twice that amount for a married couple) to as many individuals as you want without incurring any federal gift tax consequences. If you gift an appreciated asset, you won't have to pay tax on the gain; any tax is deferred until the recipient of your gift disposes of the property.

Postpone the Inevitable

To reduce your taxable income this year, consider maximizing pretax contributions to an employer-sponsored retirement plan such as a 401(k). You won't be taxed on the contributions you make now, and you may be in a lower tax bracket when you do eventually withdraw the funds and report the income. (Note that if you take withdrawals from the plan before age 59½, you'll generally be subject to a 10 percent penalty tax in addition to any income tax due, unless an exception applies.)

If you qualify, you might also consider making either a tax-deductible contribution to a traditional IRA or an after-tax contribution to a Roth IRA. In the first instance, a current income tax deduction effectively defers income — and its taxation — to future years (as with a retirement plan, an additional 10 percent penalty tax will apply to withdrawals made prior to age 59½ in addition to any income tax due, unless an exception applies); in the second, while there's no current tax deduction allowed, qualifying distributions you take later will be tax free. You'll generally have until the due date of your federal income tax return to make these contributions.

Tax planning can be complicated. Consider seeking the assistance of a tax professional to determine what year-end tax planning moves, if any, are right for your individual circumstances.

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Hybrid Funds: Balanced, Lifestyle, or Target?

Although the goal of hybrid funds is simplicity, they are not as simple as they may appear, and different types of hybrid funds have very different objectives.

Holding a mix of stocks and bonds is fundamental to building a portfolio that can pursue growth while potentially remaining more stable than a stock-only portfolio during market downturns. Many investors approach this goal by owning a mix of individual securities, a mix of funds, or both. However, some hybrid funds try to follow the same strategy in a single investment.

Although the goal of these funds is simplicity, they are not as simple as they may appear, and different types of hybrid funds have very different objectives.

Balanced funds

Balanced funds typically strive for a specific asset mix — for example, 60% stocks and 40% bonds — but the balance might vary within limits spelled out in the prospectus. Theoretically, the stocks in the fund provide the potential for gains while the bonds may help reduce the effects of market volatility.

Generally, balanced funds have three objectives: conserve principal, provide income, and pursue long-term growth. Of course, there is no guarantee that a fund will meet its objectives. If you are investing in a balanced fund or considering whether to do so, you should understand the fund's asset mix, objectives, and rebalancing guidelines as the asset mix changes due to market performance. Rebalancing is typically necessary to keep a balanced fund on track, but could create a taxable event for investors.

Lifestyle funds

Lifestyle funds, also called target-risk funds, include a mix of assets designed to maintain a consistent level of risk. These funds may be labeled with terms such as conservative, moderate, or aggressive. Because the targeted risk level remains consistent over time, you may want to shift assets from one lifestyle fund to another as you approach retirement or retire. A conservative lifestyle fund might be an appropriate holding throughout retirement.

Target-date funds

Target-date funds contain a mix of assets selected for a specific time horizon. The target date, usually included in the fund's name, is the approximate date when an investor would withdraw money for retirement or another purpose, such as paying for college. An investor expecting to retire in 2035, for example, might choose a 2035 fund. As the target date approaches, the fund typically shifts toward a more conservative asset allocation to help conserve the value it may have accumulated. This transition is driven by a formula called the glide path, which determines how the asset mix will change over time. The glide path may end at the target date or continue to shift assets beyond the target date.

Funds with the same target date may vary not only in their glide path but also in the underlying asset allocation, investment holdings, turnover rate, fees, and fund performance. Variation tends to be greater as funds near their target date. If you own a target-date fund and are nearing the target date, be sure you understand the asset mix and whether the glide path extends beyond the target date.

All in one?

Traditional balanced funds typically contain a mix of individual securities. Although these funds may be an appropriate core holding for a diversified portfolio, they are generally not intended to be an investor's only holding. However, some balanced funds and most lifestyle and target-date funds include a mix of other funds. These "funds of funds" are often intended to offer an all-in-one portfolio investment. You may still want to hold other investments, but keep in mind that investing outside of an all-in-one fund may change your overall asset allocation. Asset allocation and diversification are widely accepted methods to help manage investment risk; they do not guarantee a profit or protect against investment loss.

Additional considerations

The principal value of a target-date fund is not guaranteed before, on, or after the target date. There is no guarantee that you will be prepared for retirement on the target date or that any fund will meet its stated goals. The return and principal value of all funds fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost.

Mutual funds are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

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How can I tell if a crowdsourcing campaign is a scam?

Crowdsourcing can be an effective way to raise funds for a variety of causes, but it's also a great opportunity for scam artists to take advantage of your goodwill. Before you donate to a crowdsourcing campaign, help protect yourself from being scammed by following these tips.

Check the campaign creator's credibility. If you don't personally know the campaign creator, it might be worth your time to review his or her social media profiles. This should be easy to do, since most crowdsourcing platforms link social media accounts to campaigns. When you visit a profile, look for red flags. Does the profile seem new? Does the campaign creator have friends or followers listed on the profile? Does the campaign creator have just one social media account? Does the profile seem active or old/unused? Answering "yes" to any of these questions should cause you to question the legitimacy of a crowdsourcing campaign.

Research the crowdsourcing platform. Many different crowdsourcing platforms exist, from the well established to the startups with no track record. Review a platform's terms and policies before you donate to one of its crowdsourcing campaigns. Find out how long it's been in business and whether it evaluates or checks out campaign creators. Determine whether the platform will refund money or take responsibility for a crowdsourcing campaign scam. Remember to look for the secure lock symbol and the letters *https:* in the address bar of your Internet browser — this indicates that you're navigating to a legitimate web address.

Consider the timing of the campaign. Be wary of campaigns that are created after national disasters. It's unfortunate, but scam artists often exploit tragedies to appeal to your sense of generosity. In the case of disaster relief, bear in mind that it's probably safer to donate money to established nonprofit organizations with proven track records than to a crowdsourcing campaign.

If you've been defrauded or suspect fraudulent activity, report your experience to the crowdsourcing platform. You can also file a complaint with the Federal Trade Commission (FTC).

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