
Now is the time to begin your year-end tax planning

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This is that time of the year when most tax experts say you should start thinking about your end-of-the-year tax strategies.

By starting to plan a few months before Dec. 31, you might buy yourself just enough time to adopt new tax strategies or strengthen existing plans to get your finances into shape.

"The more you think about it in advance, the easier year-end becomes," said Dave Sadler, an accountant and financial planner with the St. Louis-based accounting firm Moneta Group LLC.

By fall, most self-employed physicians whose incomes vary with their practice revenues should have a pretty good sense of whether they are having a higher- or lower-than-average income year, tax experts said. That should enable them to decide whether they should be looking for deductions or trying to save those strategies for future years.

Strategies tend to fall into one of four major categories: making equipment purchasing decisions, changing your retirement plan, making charitable donations, and spending down some practice income.

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Buying equipment

Many tax experts will tell you to first consider making equipment purchases for your practice as one way to reduce your tax bite. A rule known as the Section 179 deduction may allow you to write off up to \$108,000 in equipment and computer purchases for assets that were put into service in 2006, as long as the assets qualify, and your total asset purchases for the year did not exceed \$430,000.

The law, passed in 2003, set a base deduction of \$100,000, which has since risen incrementally with inflation. The deduction will be available again in 2007. However, it is set to expire in 2008 unless lawmakers intervene. So unless things change, physicians have less than two years to spread out their major equipment purchases to take advantage of this deduction.

However, this doesn't mean a practice can load up on equipment. If a purchase this year is going to push the practice over the \$430,000 limit, it's better to wait to buy until next year, said Maxine Lawyer, a tax partner and director of medical practice and health care services for the Dallas-based accounting firm Weaver & Tidwell LLP.

Also, Sadler advises these decisions should be weighed soon, because major equipment purchases can take months to research properly.

So the equipment option is likely to work best for groups that have already planned for a purchase but are deciding when to pull the trigger on a deal. A group that buys equipment on the fly for the tax savings is the group that will lose even more money later when it has to junk the equipment it didn't buy wisely.

Retirement planning

The clock also is ticking for physicians who are considering changes to their retirement plans. Some of those changes must be in place well before the end of the year in order to get a tax break for them in 2006.

A physician who decides to set up a 401(k) plan must do so before Oct. 1 to deduct contributions to it in the 2006 tax year, said Bill Rucci, a partner with the accounting firm Rucci, Bardaro & Barrett PC in Malden, Mass. On the other hand, a SEP-IRA --Simplified Employee Pension Plan, a retirement plan designed for the self-employed and for small businesses -- may be funded after the calendar year is over so long as it is done by the time the tax filing is made.

Some physicians might want to consider a switch to a relatively new type of retirement plan strategy that is gaining popularity among some small business owners, said Alan Badey, a partner in the White Plains, N.Y., office of the accounting and consulting firm Citrin Cooperman & Co. LLP. The so-called cash balance plan is a defined benefit plan that allows its holder the option of either monthly payments or a lump-sum distribution upon retirement. In other defined

benefit plans, the benefit is defined as a specified monthly payment, rather than an account balance.

To take advantage of their tax benefits, such plans must be set up by an actuary and implemented before the end of the year, even though they may be funded after the year's end, so it is important to consider this option well before December, Badey said.

However, unlike a defined-contribution plan such as 401(k), the cash balance plan puts a risk on the employer, not the employee, to fund retirement payments. The money for the plan comes from a defined annual payment and interest credit (such as 5% of salary), not from the employee's own investment. So if you want to create a cash balance plan for your practice, your employees will have to participate as well.

Charitable giving

For many people, it takes the appearance of the bell-ringers at the supermarket to remind them to make charitable donations before the end of the year. But Sadler said such philanthropy should be weighed well before then, in conjunction with other tax planning, in order to take full advantage of the potential tax breaks that come with it.

Physicians who know they will have substantially less income in the following year -- perhaps because they are retiring or because they had a revenue source in 2006 that is expiring -- might want to consider pre-funding their charitable contributions for future years in order to get the tax break when it is most needed. One way to do that is by establishing a charitable gift fund, which can be pre-funded and then used to distribute grants to charitable endeavors later. Sadler said most of those funds require a minimum initial contribution of at least \$10,000, which could then serve as a significant write-off in the year it was made.

Another means of giving in a tax-savvy way is by donating appreciated securities, which allows gifts to be made without realizing capital gains on the investment, provided the security was held for more than one year. Sadler said this should only be done in situations in which the value of the contribution justifies the cost of selling the stock.

Spending cash

Even after adopting all of these strategies, you or your practice might have cash left over at the end of the year that could translate into a major tax burden. So, many experts recommend finding ways to

spend down that money before the tax year is over.

One way to do this is by pre-funding certain practice expenses for the following year, such as rent, supplies or insurance, said Badey. He said that the federal government recently came out with guidance indicating that such maneuvering can be done within the parameters of tax law. Even though that would mean those expenses wouldn't be deductible in 2007, Badey said it could be possible to use the same strategy next year and keep the cycle going.

Another way to draw down your leftover income would be to prepay the state income tax you will owe when you file in 2007, said Sadler. If the payment is made in 2006, it could count as an itemized deduction on your 2006 federal tax return.

Sadler said this strategy can be an effective way to minimize your federal tax burden for a given year. However, he said that if you are subject to the alternative minimum tax, you won't be able to take advantage of this strategy.