

# **PREPARE AND SAVE**

## **APRIL 2007**

So 2006 is history! Nothing you can do about that tax bill but there is plenty you can do to prepare for this year. The following are a few easy-to-do strategies to make April 15, 2008 a little more pleasant and possibly less costly.

### **Get Organized**

Create a folder for the 2007 tax year and store all tax related information, including tax payments, charitable contributions, HSA and/or IRA payments, and cost basis for investment transactions. Basically everything and anything that can be considered a taxable event. Trying to locate these things at the last minute does nothing but add gray hair.

### **Understand the Qualified**

Interest from taxable bonds and most dividends from real-estate investment trusts are taxed as ordinary income which in turn means being taxed as much as 35% to federal government. When reviewing portfolios from new clients we unfortunately often see tax-free or lower tax income investments in qualified accounts and higher tax investments in non-qualified taxable accounts costing investors thousands in unnecessary taxes. Common sense dictates that less tax-efficient investments be held in IRA's or 401(k)'s.

### **Avoid Penalties**

When it comes to retirement accounts do not cash out early. Cashing out early triggers income taxes and penalties as well. In a report by the Vanguard Group entitled *Analyzing the 401(k)* they calculate that when individuals leave their employer 29% take part or all of their account balances as a lump sum rather than rolling it into another tax-deferred account.

### **Structured Portfolios**

It is important to handle your taxable account with care. As your taxable account grows it is important to try to put investments that yield qualified dividends and try to avoid short-term capital gains. Remember that short-term gains are taxed as ordinary income while long-term gains are taxed at 5% or 15%.

### **Max Out the Retirement Accounts**

Always try to fully fund your 401(k), 403(b) or IRA's. Not only will you lower your tax bill but you will often pick up matching contributions from your employer. Americans throw away billions annually in matching contributions every year. In the Vanguard report 36% of eligible workers fail to even sign up. The bottom line is tax deduction plus tax deferred growth is a beautiful thing!

### **Manage Debt**

Credit card and auto loan interest payments are not tax deductible. It is often prudent to take out home equity loans to pay off such debt. However, after paying off the debt DO NOT load yourself up with debt again. According to the Federal Reserve, the average interest rate levied on credit-card accounts is closing in on 15%, which for all intents and purposes is financial lunacy. Home equity lines are tax-deductible and have lower interest rates. However, they ARE NOT for vacations and plasma televisions. Use wisely!