



Tax Planning for Income

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Tax planning for income usually involves strategies for minimizing your taxable income. In particular, the timing and the method by which your income is reported become paramount. Effective planning begins with an understanding of the various types of income. Next, you'll want to consider tools for creating tax-free income, methods of sheltering earned income from taxes, strategies to defer taxes (and other tax-advantaged strategies), and vehicles for shifting income and tax. For older taxpayers, it's also useful to know how to minimize taxation of your Social Security benefits.

How can you shelter earned income from taxes?

Sheltering your earned income involves employing one or more tools to generate losses, deductions or credits that will reduce the current federal tax burden on your earned income. Typically, your desired result is income deferral. Several methods exist to shelter earned income from taxes, including traditional deductible IRAs and employer-sponsored retirement plans.

Why should you be aware of strategies to defer taxes?

There are several reasons why deferring the taxation of income is generally desirable. First, deferring taxes will provide you with more money right now to fund various financial plans. Moreover, certain qualified retirement plans allow you not only to defer some of your current taxable income, but also let your retirement savings grow tax-free until a distribution is taken.

As a general rule, when tax rates are stable, it's wise for you to defer the recognition of as much income as possible to a later year and accelerate deductions. This will allow you to minimize your current income tax liability. Consequently, you will be able to invest money that would otherwise have been used to pay income taxes, keeping that money working for you. When you eventually recognize the income, it's possible that you'll be in a lower tax bracket.

What are some other tax-advantaged strategies?

Many other tax-advantaged strategies exist. For instance, you should be aware of tax shelters and tools for creating passive income in order to take advantage of passive losses. Additional strategies that may help you reduce your overall income tax burden include taking advantage of the tax benefits of generating capital gains, investing in real estate, receiving annuitized payments and engaging in year-end tax planning.

What about Social Security benefits?

If you're an older taxpayer, you should probably be concerned with minimizing the taxation of your Social Security retirement benefits. Certain techniques exist to limit the taxation of such benefits, including filing your income tax return jointly and employing tools to reduce your modified adjusted gross income.

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