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Year-End Tax Check: Questions to Ask

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Now is the ideal time to start year-end tax planning so that credits and deductions can be maximized before the December 31st deadline. Personal and financial events, such as getting married, sending a child off to college, or retiring happen throughout the year, and can have a big impact on your taxes. If you wait until the end of the year or next spring to factor those changes into your tax planning, it might be too late.

Here are questions to answer to help you be prepared for any potential impacts on your tax return.

Did you get a raise or are you expecting one?

The amount of tax withheld from your paycheck should increase automatically along with your higher income. However, if you're working two jobs, have significant outside income (from investments or self-employment), or you and your spouse file a joint tax return, the raise could push you into a higher tax bracket that may not be accounted for in the Form W-4 on file with your employer. Even if you aren't getting a raise, ensuring that your withholding lines up closely with your anticipated tax liability is smart tax planning.

Are you saving as much as you can in tax-advantaged accounts?

Contributing to a qualified retirement plan is one of the most effective ways to lower your current-year taxable income, and the sooner you bump up your contributions, the more tax savings you can accumulate. For 2016, you can contribute up to $18,000 in pretax dollars to your 401(k) or 403(b). If you're age 50 or older, you can make a "catch-up" contribution of as much as $6,000, for a maximum total contribution of $24,000. Self-employed individuals with a simplified employee pension (SEP) plan can contribute up to 25% of their compensation, to a maximum of $53,000.

This year's IRA contribution limits for both traditional and Roth IRAs are $5,500 per qualified taxpayer under age 50 and $6,500 for those age 50 and older. Traditional and Roth IRAs both have advantages, but keep in mind that only traditional IRA contributions can reduce your taxable income in the current year.

Do you have a newborn or a child no longer living at home?

It's time to plan ahead for the impact of claiming one more or less dependent on your tax return. Consider adjusting your tax withholding if you have a newborn or if you adopt a child. With all the expenses associated with having a child, you don't want to be giving the IRS more of your paycheck than you need to. If your child is a full-time college student, you can generally continue to claim him or her as a dependent—and take the dependent exemption ($4,050 in 2016)—until your student turns 25. If your child isn't a full-time student, you lose the deduction in the year he or she turns 19.

Do you have a child or grandchild starting college?

College tuition can be eye-popping, but at least you might have an opportunity for a tax break. There are several possibilities, including if you qualify, the American Opportunity Tax Credit (AOTC). The AOTC can be worth up to $2,500 per undergraduate every year for four years. Different college-related credits and deductions have different rules, so it pays to look into which will work best for you.

Supercharge a 529 plan—affluent individuals can contribute $70,000 and affluent couples (parents and grandparents) can contribute $140,000 to a plan without incurring any gift tax. In addition, some states offer tax deductions or credits against 529 plan contributions.

Is your marital status changing?

Whether you're getting married or divorced, the tax consequences can be significant. In the case of a marriage, you might be able to save on taxes by filing jointly. If that's your intention, you should reevaluate your tax withholding rate on Form W-4.

Getting divorced, on the other hand, may increase your tax liability as a single taxpayer. Again, revisiting your Form W-4 is in order so you don't end up with a big tax surprise in April. Also keep in mind that alimony you pay is a deduction, while alimony you receive is treated as income.

Are you getting ready to retire or reaching age 70½?

If you'll be age 70½ this year, don't forget that you may need to start taking a minimum required distribution (MRD) from your tax-deferred retirement accounts, although there are some exceptions. You generally have until April 1 of next year to take your first MRD, but after that, the annual distribution must happen by December 31 if you want to avoid a steep penalty. So if you decide to wait to take your first MRD until next year, be aware that you'll be paying tax on two annual distributions when you file your 2017 return.

Do you need to accelerate expenses and/or decelerate income?

Consider strategies to defer earned income or shift some of your income-generating investments to tax-advantaged retirement accounts. Make an extra mortgage payment or two. Gift money to your children and grandchildren to remove it from your estate. In 2016 the maximum amount that an individual can give without incurring a gift tax is $14,000; married couples can give $28,000. Make cash gifts or donate appreciated stocks to non-profit organizations.

Before making any year-end tax moves, we recommend you consult with your tax advisor to ensure that the moves you make are the right ones.

Source: Fidelity, “Midyear Tax Check: Nine Questions to Ask”, 8/9/16