

Tiku: Smart financial strategies to usher in the new year

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The new year is upon us and for many of us it's also time for introspection, reminiscence and eternal hope. Not surprisingly, this also turns out to be the time for resolutions and promises for the coming year.

It's in that spirit of ushering in the new year that I have prepared a list of financial strategies and included some of the new twists that offer opportunities to do better financially as we make our way through 2006.

401(k) plans

New twist -- higher contributions and Roth 401(k).

The limit for 401(k) contributions has been raised from \$14,000 to \$15,000 with an additional "catch-up" for those over 50 of additional \$5,000.

Contributing maximum to a 401(k) offers a great reward at tax time -- since contributions as well as any growth is fully tax deferred. These limits are the same for other employer-sponsored plans such as 403(b), and 457 plans usually set up for nonprofit or educational institutions.

Be sure to check if your employer matches your contributions. If you are not contributing at least up to the match amount, you are leaving money on the table.

Starting this year, there is also a new 401(k) plan not available before called Roth 401(k). Many employers are making this option available to their employees. This plan, like the regular 401(k) plan, allows both employee and employers to contribute income, but the contributions are not tax-deductible to employees. However, the entire amount will be free on any income taxes at the time of distribution.

IRA contributions

New twist -- higher contributions, Roth or regular, Roth conversion

For 2006 and 2007 the contribution is \$4,000 per year either for regular or Roth IRAs, with a "catch-up" of additional \$1,000 for those over age 50.

Whether to contribute to a regular IRA or Roth IRA may depend on your current tax bracket. If you are in a low tax bracket and are likely to be in a higher tax bracket in future years, then a Roth IRA is likely to be more beneficial.

However, if you are in a high bracket now and likely to be in a lower tax bracket at the time of retirement, then a regular IRA may be a better option because you will be able to deduct contributions unless you have exceeded income limits. You have until next April 15, 2006, to make the contributions for 2005.

Some people who might be in a low tax bracket could also consider converting their regular IRA to a Roth IRA. This would mean you pay taxes on the amount of IRA converted now but the entire amount including all the future growth will escape taxes as you are ready to take the money out.

Alternative Minimum Tax

New twist -- more people likely to get caught up in AMT trap.

Many individuals are likely to get caught in the spiral of Alternative Minimum Tax (AMT) resulting in loss of many valuable deductions and causing them to pay much higher tax.

According to tax adviser Steve Friedman of the Newton firm Friedman, Suvalle and Salomon, this is a stealth tax with many hidden traps. More and more people are surprised each year at tax time when they are faced with a big tax bill as a result of AMT, said Friedman.

According to Friedman, people with stock option income, high real estate and local and state tax deductions, certain types of high mortgage interest deductions may be ripe for an AMT tax and should plan ahead in order to avoid an unwelcome surprise when they figure their taxes.

Make tax-free gift

New twist -- shift income.

If you are interested in shifting income to a family member (not your spouse) who is in a lower tax bracket, such as a child or you want to reduce your potential estate, then consider gifting.

A single person is entitled to \$11,000 per person per year and a couple can combine gifts to make a total of \$22,000/year in gifts to a single person.

Donate smartly

New twist -- charitable gift trust, fully deductible

If you are donating money to a charity, consider donating low-basis stock or even mutual funds, instead of cash. Doing this saves you from paying capital gains tax and you get full deduction on your taxes for the market value of the stock or mutual fund.

If you find yourself donating small amounts to a number of charities, you should consider a charitable gift trust. These trusts, also known as donor advised charitable trusts, allow you to make a single or multiple donations of cash or preferably low-basis stock or mutual funds or even real estate and other items of value and you can advise or direct the trustee to make donations on your behalf in amounts you desire, at a time of your choosing to make the donations on your behalf.

Charitable gift trusts can be set up readily through companies such as Fidelity and Charles Schwab. Certain minimums and conditions apply.

While this above list is not exhaustive, it is a good starting point for many who are keen on starting the new year on the right foot financially and enjoy the fruits even after the euphoria of the champagne toast is long over.

In the coming installment we will add more details and expand the list further.