<u>Update Newsletter for Individuals - 2003</u>

***What is all of the 'news' hype over SUVs and the new depreciation laws?** Vehicles that weigh more than 6,000 lbs and are used more than 50% of the time in a trade or business may use the Sec 179 election to write off the business use percentage in the first year that the vehicle is placed into service. This is not a new law - what is new is the Sec 179 election has increased to $100,000 for the 2003 year. If you purchase a vehicle that weighs more than 6,000 lbs at a cost of $50,000 that is used 80% of the time for business, you can write off $40,000 in depreciation in the first year if you are using the 'actual' expense method. There are downfalls to doing this....1) If the business percentage use drops below the 80% or if the vehicle is disposed of or sold before the 5 year depreciation period, then you must recapture (or add back income on your tax return - the add back is the amount of depreciation that was taken for years the vehicle will not be in service). It is as though you took everything in the first year instead of spreading it over a 5 year period; 2) You must continue to take the actual expenses for the remaining years (tracking gas, repairs, etc) instead of using the standard rate; 3) It may not be the best tax strategy to take all of the depreciation in the first year leaving no deduction against income for future years. For a list of vehicles that weigh more than 6,000 lbs see the "Information Center" button on my website. Please contact me if you have specific questions as this applies to your business. **Important tax tip** - This loophole is being closed. The Senate has already passed a bill that will disallow the total $100,000 Sec 179 on SUVs which would take effect on 1/1/04.

***Did you refinance this year?** Almost everyone has refinanced in the last couple of years with the lower interest rates. This has been great for increasing cash flow but be aware that it may increase your taxes. Many taxpayers are paying lower interest rates and therefore will have a lower mortgage interest write off which increases the taxable income. Be sure to bring in your refinance settlement sheet for the preparation of your tax return. Any points paid at refinance are considered to be mortgage interest and will be written off over the length of the loan using an amortization schedule. If you had a prior refinance with points, the remaining unamortized points can be taken as a deduction.

***Capital Gains Tax** - Yes, the capital gains rate has been reduced to 15% on May 6, 2003. It will be very important to note the dates of sale as the tax will be treated differently according to the sale date. For taxpayers in the 15% tax bracket, their capital gains rate will be 10%. Be sure to review your capital gains and losses realized so far this year. If you have net gains, take offsetting losses of equal value to make them tax free. If you have net losses, use them before year-end by realizing a gain. The maximum allowable capital loss in one year is $3,000. If your loss is greater than the $3,000, the excess is carried forward to future tax years.

***IRAs** - Putting money into a individual retirement account is a good idea but can be very tricky. If you are eligible to participate in a retirement plan with your employer or your income exceeds $150,000 (Married Filing Jointly) or $40,000 (Single), you may be limited or not eligible to take a deduction for a contribution to a traditional IRA. You may want to make the contribution anyway but it will be necessary to track the non-deductible amounts on Form 8606. If the non-deductible amounts are not tracked, you could end up paying tax on the money twice.

The Roth IRA has become very appealing as the contributions to it will not be taxed when withdrawn as long as the money is in the account for at least 5 years or the taxpayer is age 59 ½ at the withdrawal date. You are not eligible to make a Roth contribution once your adjusted gross income exceeds $160,000 (Married Filing Jointly) or $110,000 (Single). If you have concerns about the limits, please contact me.

The maximum contribution amount is $3,000 if you are under 50 yrs of age and $3,500 if you are age 50 as of 12/31/03. This is applicable to both the traditional and the Roth IRAs.

***Retirement Contributions** - Contributing to a retirement account through your employer is always a great tax break. The income and earnings are non-taxable in the current year but become taxable upon withdrawal. There is a 10% penalty if the money is withdrawn before age 59 1/2. The maximum deferral for 401Ks and 403bs has increased to $12,000 for 2003. If you are age 50 or older by 12/31/03, this increases to $14,000. Please let me know if you decide to do an early withdrawal from a qualified retirement account. You will lose at least 30% and sometimes as high as 50% to taxes on an early withdrawal.

***Charity** - If you give more than $250 either in cash or noncash items, a receipt or letter is required before you file your income tax return. If you do not receive a detailed list, take pictures of the donated items and make your own list. Clean out your closets before 12/31/03 and give away the items to an organization similar to Goodwill or The Salvation Army. Click on the “Information Center” on my website or www.salvationarm.org for valuation guides to assess the fair market value of the items you are giving away. If the letter from the charity is dated after the filing date of the return, the deduction will be denied by the IRS. If you give more than $500, a detailed list is required to be included in the tax return. If you donate a vehicle and fix your own valuation, start with the car’s blue book value at www.kbb.com and be sure to account for the car’s mileage and condition. We request a printout of this valuation as documentation for your deduction. If your noncash contribution exceeds $5,000, a written professional appraisal is required for the tax return.

Donate Appreciated Stock to Charity - If you purchased stock for $1.00 per share and the fair market value is now $10.00 per share, you can avoid paying capital gains on the $9.00 increase in price by gifting it to a qualified charity. Not only that, you receive a charitable contribution deduction for the fair market value of $10.00 per share when you only had an out-of-pocket expense of $1.00 per share. This transaction must be well documented with a letter from the charitable organization and proof of the fair market value on the date that it was gifted.

Charges to your Credit Card - Deductible expenses such as medical bills, charitable contributions, and business supply purchases can be deductible if you charge them to your general use credit cards (Visa, Master Card, etc) before 12/31/03. This does not apply to specific store credit cards.

***AMT** - Alternative Minimum Tax is a parallel tax system that is used to make sure that high income earners are not escaping taxation. The new lower tax rates mean that more taxpayers will be facing this parallel tax system. AMT requires adjustments to the regular taxable income for tax preference items and this eliminates favorable deductions. The maximum alternative tax rate is 28% but the problem is that tax is recalculated at a higher taxable income amount causing a higher tax bill than expected. If you are subjected to AMT, it will not benefit you to make your 4^{th} quarter estimated state income tax payment by December 31^{st}. Making this payment in 2003 is usually a good tax tip but if you are subjected to AMT, state taxes are a disallowed deduction and will not reduce your IRS tax liability.

***College tuition** - We now have both a higher education deduction and a higher education credit. The deduction is maximized at $3,000 and the credit can go up to $2,000. The tax return must be prepared both ways in order to determine what is the greater tax break to the taxpayer. Taxpayers are not allowed to claim both the deduction and the credit in the same year for the same student. There are adjusted gross income phase-out amounts for the deduction that start at $130,000 for a Married Filing Joint return and $65,000 for a Single return. The phase-outs for the credit are different starting at $103,000 for a Married Filing Joint return and $51,000 for a Single return. The education expenses must be paid during the year and cover tuition and fees (not books, room, board, or activity fees). There are two available credits - The first is the Hope Credit for first and second year students who attend school at least half time. The second is the Lifetime Learning Credit which is available for any student and there is no limit to the number of years that this credit can be claimed.

***Student Loan Interest** - In order to claim this deduction the taxpayer does not have to itemize. The maximum deduction for 2003 if $2,500. The loan must have been incurred to pay qualifying expenses (tuition, fees, books, room and board) for the taxpayer, spouse, or dependent. There are phase-out limitations due to adjusted gross income starting at $100,000 for Married Filing Jointly and $50,000 for Single.

***Child Credit** - The maximum child credit for 2003 is $1,000 per child under the age of 17. If you received an advanced payment of $400, it will reduce the credit to $600 on your income tax return. Please let us know what amounts (if any) you received for the advanced payment from the IRS during 2003 - this information will be necessary to prepare your tax return. If you received an advanced payment but don't qualify for the child credit on the 2003 return, you get to keep the money!! This is happening especially in the cases of divorce when the parents alternate the child exemption each year. There could be many reasons for not receiving an advanced payment - the most likely reason is that your adjusted gross income was too high. If you have two children and are filing a joint return for the 2003 year and have gross income of $149,000 or more, you will not get the credit. There are different phase out amounts according to your filing status and number of children.

***Dependent Day Care Credit** - The child and dependent day care credit has increased for the 2003 year. The maximum expenses for one child increased from $2,400 to $3,000 and for two children from $4,800 to $6,000. Depending upon a taxpayer's income, the maximum credit for one child could be $1,050 and $2,100 for two children.

***New Mileage Rates** - The standard business mileage rate for the 2003 year is 36 cents per mile. This rate will increase to 37 ½ cents per mile starting January 1, 2004. Charity work mileage for 2003 and 2004 is 14 cents per mile. Moving and medical mileage for 2003 is 12 cents per mile but will increase to 14 cents per mile starting January 1, 2004.

***Rental Properties** - Owning a rental property will not give you a current year tax break if your income is greater than $150,000. Once your adjusted gross income reaches $100,000, your losses will begin to phase out as a current year deduction. No losses are allowed in the current year if your adjusted gross income exceeds $150,000 unless you are in the business of real estate management. The disallowed losses will carry forward until the year that your income drops below the $150,000 or you sell the property. Please contact our offices if you are intending on selling your rental so we can review the tax consequences.

***Inheritance** - In general, money and assets received through an inheritance are not taxable income. There is an exception for annuities and IRA accounts. If you have received a distribution from an IRA or annuity due to a death, you will most likely be taxed on the income on your individual income tax return.

***Sale of Personal Residence** - In general, if you have both lived in and owned your personal residence for 2 of the last 5 years and the gain is not larger than $500,000 (Married Filing Jointly) and $250,000 (Single), then there is no capital gains due on the sale. If you have been in the home less than 2 years, you may qualify for a reduced exclusion and still not be subjected to the gains tax. The reduced exclusion is available for medical purposes, changing jobs, and unforeseen circumstances (such as death, divorce, multiple births, and disasters). Please let me know if you are selling your personal residence so we can review the tax consequences.

***Moving** - The moving deduction is available only if you have changed jobs and moved at least 50 miles. The new job and home must be more than 50 miles from the former job and home. Remember to always inform the IRS of a change of address. This can be done by completing Form 8822. The form can be found at their website www.irs.gov or we can provide the form if you give us a call.

****

Privacy Statement

Federal law requires that once a year I inform you of our Privacy Policy. As you know, we collect certain personal information about you in order to prepare your tax returns. The information is either provided by you or obtained by our office with your permission. No personal information will ever be disclosed about you to anyone except that which is already public by law.

Should you become an inactive customer, we will continue to adhere to the policy regulations as written here. The information you give us about your personal or business records is reserved only for our employees who need to know in order to service your account.

Procedural, physical, and electronic safeguards will be maintained in compliance with Federal standards regarding your personal information. We are committed to retaining your confidence, and want to assure you that any information you give us remains safe and confidential.