

**Lisa A. Scarazzo, CPA, PC**  
**Annual Individual Tax Newsletter**  
**November 2004**

12904 Harbor Drive  
Fairfield Office Park  
Woodbridge, VA 22192

703/690-4257  
703/491-2794  
703/492-6829 Fax  
www.lascpa.com

**Tax Update Newsletter for Individuals - 2004**

**What is new for 2004?**

**ELECTRONIC FILING** - Due to government requirements being placed on tax practitioners, our office will be filing **all individual income tax returns electronically** for the 2004 tax year. There will be no charge for this service. It will be necessary for the taxpayer to review and approve his or her tax return before we transmit the data electronically to the IRS and the state.

**The Working Families Tax Relief Act of 2004 & American Jobs Creation Act of 2004** have brought on some changes and reaffirmed that we will be keeping some important tax breaks including the \$1,000 Child Tax Credit. There is an increase to the standard deduction, which is an attempt to bring on tax relief for taxpayers in the marriage-penalty bracket. I am listing an overview of tax items that will have the biggest impact on my clients below:

**\*Sales Tax Deduction** - The new tax law allows taxpayers to elect to either take their sales tax paid during the year or their state local income taxes as an itemized deduction. This law was implemented primarily for some states that do not have state income tax. It will not be necessary to add up each receipt for the year because the IRS will provide a sales tax table to be used for the tax preparation. We will check to see which item (either the sales tax or the state income tax) will give the taxpayer the greater deduction. If you have purchased a vehicle and/or boat during the 2004 year, bring in the documents showing the sales tax, as those items will be in addition to the IRS sales tax tables.

**\*Child Credit** - The maximum child credit for 2004 is \$1,000 per child under the age of 17. If you have two children, are filing a joint return for the 2004 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.

**\*New Mileage Rates** - The standard business mileage rate for the 2004-year is 37.5 cents per mile. This rate will increase to **40.5 cents** per mile starting January 1, 2005. Charity work mileage for 2004 is 14 cents per mile. Moving and medical mileage for 2004 is 14 cents per mile.

**\*Attention Teachers** - The educator deduction has been renewed through 2005. You may claim a deduction of \$250 for expenses paid for your classroom including books, supplies, computer equipment, and supplementary materials.

**\*IRAs** - Putting money into an 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 \$65,000 (Married Filing Jointly) or \$45,000 (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 as the phase-outs actually start at \$150,000 adjusted gross income (MFJ) and \$95,000 (Single).

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 12/31/04. This is applicable to both the traditional and the Roth IRAs. The maximum contribution will increase for the 2005 year to \$4,000 under age 50 and \$4,500 if you are age 50 as of 12/31/05.

**\*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 \$13,000 for 2004. If you are age 50 or older by 12/31/04, this increases to \$16,000. **Alert for 2005**, the maximum deferral for 401(k)s and 403(b)s is **\$14,000** - and if you are age 50 or older by 12/31/05, it is **\$18,000**. Check with your HR Department to increase your contribution amounts in January 2005. 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 in cash or non-cash items to a charity, 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 12/31/04 and give away the items to an organization similar to Goodwill or The Salvation Army. Click on the "Information Center" on my Web site or [www.salvationarm.org](http://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 IRS will deny the deduction. 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](http://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 non-cash contribution exceeds \$5,000, a written professional appraisal is required for the tax return.

**TAX CHANGE FOR 2005** - If you give away a vehicle and the fair market value is greater than \$500, you will need written documentation from the charity stating the amount they resold your vehicle for - you will only be allowed a deduction for the amount they received in the sale and not the blue book value!!

**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 12/31/04. This does not apply to specific store credit cards.

**\*Dependent Day Care Credit** - The maximum childcare expenses for one child is \$3,000 and for two or more children is \$6,000. Depending upon a taxpayer's income, the maximum credit for one child could be \$1,050 or \$2,100 for two or more children.

**\*College tuition** - We now have both a higher education deduction and a higher education credit. The deduction is maximized at \$4,000 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 \$85,000 for a Married Filing Joint return and \$42,000 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. There is no limit to the number of years that this credit can be claimed.

**\*Tax loop closes for depreciation write offs on SUVs as of 10/22/04** - 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 write off is still available, but the Sec 179 amount has decreased from \$100,000 to \$25,000 as of 10/22/04. For a list of vehicles that weigh more than 6,000 lbs see the "Information Center" button on my Web site at [www.lascpa.com](http://www.lascpa.com). Please contact me if you have specific questions as this applies to your business.

**\*Bonus Depreciation** - Important note to business owners: This is the last year for the extra 30% and 50% additional bonus depreciation. If you are thinking of making a large purchase in 2005, consider moving that purchase into the 2004 year.

**\*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** - The capital gains rate was reduced to 15% on May 6, 2003. 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 \$3,000, the excess is carried forward to future tax years.

**\*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 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<sup>th</sup> quarter estimated state income tax payment by December 31<sup>st</sup>. Making this payment in 2004 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.

**\*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 \$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 the IRS Web site [www.irs.gov](http://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.