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TAX NEWS & TIPS

YEAR-END 2004

Tax Time is Near!

2005 is almost here. You can still reduce your 2004 income tax. I've got news of last-minute law changes and some suggestions on trimming your tax bill. Read this carefully while there is still time for savings!

Late Tax Laws Make Changes For 2004

Congress got busy just before the elections. Three new tax laws. Some items affect 2004 tax returns. You need new kinds of information if you want the largest tax savings.

D Sales Tax Deduction If you're over 40 you might recall when we could deduct sales tax. *It's baaack*—but with a twist.

If you itemize deductions you must choose. Deduct state income tax withheld or paid. Or deduct state sales taxes. Use whichever gives the larger deduction.

Sales taxes will come from IRS tables. They give an allowance depending on income and number of people in the household. Years ago we had such tables. A household of 2-3 people, in the \$40,000-\$70,000 range got from \$300-\$700 depending upon the state where you live. If you have records you may claim the sales tax you actually paid.

In Addition if you bought a car or boat (or other items to be named by IRS) you can add this sales tax to your total above.

Win. If you live where there is no *state income tax*, you'll be happy. That's Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington & Wyoming.

Lose. If you live where there is no *sales tax*, you'll be sad. That's Alaska, Delaware, New Hampshire, Montana, and Oregon. Since Alaska

and New Hampshire have neither tax, their residents don't care.

Make a Choice. Everywhere else you'll need to choose the deduction that is best for you.

Sales Tax Tables. Tables did not exist as this was written. The law asks IRS to "do the best they can to reasonably and accurately implement this statutory provision in order to effectuate the deduction for the 2005 filing season."

D SUV Deduction Limits. An SUV placed in service October 23, 2004 or later has a new limit on first-year write-off.

Who is Affected? To "write off" a vehicle you must:

- (1) use it more than 50% for business, and
- (2) unless you are self-employed, there's also a "for convenience of employer" test. It says you must be able to show you could not have gotten the job unless you had a car.

The only question is whether you deduct the vehicle's cost "over time" or "up front". If you deduct "up front" there are tough recapture rules unless you can pass both tests for the first *six years* you own the vehicle!

In A Nutshell. Vehicles with "gross vehicle weight" (GVW) over 6,000 pounds were exempt from normal limits on depreciation. They were simply treated as another piece of machinery. As such, you could take "up front" depreciation of up to \$102,000 worth of such machinery in the first year. For vehicles placed in service after October 22 the first-year limit is scaled back to \$25,000 unless the vehicle GVW exceeds 14,000 pounds. (Not even the Hummer is this large.)

Example: suppose a \$70,000 vehicle is used 100% for business. Answers change depending upon when your business usage begins:

- Pre-October 23. It is possible to deduct the entire \$70,000.

- October 23 – December 31. Combining "up front" write-off with current "bonus" depreciation gives up to \$52,000 the first year.
- 2005 and later. First-year write-off cannot exceed \$34,000.

D Vehicle Donations.

When you donate a car, boat, or RV to charity you may deduct the car's market value. This depends on the item's condition and comparable sales. Not so for 2005! Beginning January 1, this is only true if the charity *uses* the item within its charitable function. If they *sell* it, you may claim no more than they received in the sale. In 2005 their receipt must give your name and social security number, as well as their statement of whether they used or sold the item, and if sold, they must give the gross sale price.

Example. Suppose you donate a used car to charity, and similar cars sell for \$1,500. In 2004 you need only a receipt – proving the car's value is your responsibility. But, if you give the car in 2005, suppose the

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charity sells it to a wholesaler for \$500. You need a more detailed receipt, but your deduction will be limited to \$500. Give now!

D Extenders. A September law extended several tax breaks set to expire or already expired. Some of the key provisions:

- **Teachers** continue to get a deduction for the first \$250 worth of classroom supplies without having to itemize deductions. This had expired after 2003.
- **10% Tax Bracket** was set to be smaller in 2005. Now the bracket will stay as wide.
- **Marriage Penalty relief** was set to be reduced in 2005. Now the helpful provisions will be in force through 2010.
- **Child Credit** was set to be reduced to \$700 in 2005. The credit will remain \$1,000 through 2010. Congress also made it easier to recover the credit for folks whose income is too low to benefit from the credit.

Miscellaneous Provisions.

- **Combat Pay** is not taxable. Congress will allow this pay to be used in calculating the refundable Earned Income Credit for low-income families.
- **Alternative Minimum Tax.** Congress has not revised this complex tax, but they did extend the provisions to limit its impact on large numbers of Americans.

Are You Affected? I would think a few of these items got your attention. If you think you will be affected by any of these changes we both have more work to do in the coming filing season.

Your Preparation must be more careful. The sales tax issue may benefit several of you. We don't even know yet what items IRS may allow us to add to the amounts from the tables. Vehicles and boats were mentioned, but IRS was given an OK to name other items. Be prepared!

My Preparation will be more complex as well. I'll be learning more about the changes before filing time, and will need to ask more questions.

Working together we can keep your tax as low as possible. But we definitely need to help each other.

December – Last-Minute Tax Savers

Until December 31 you can still cut your tax. Get your savings *this* year. This works unless you expect a very large jump in income next year. To save in 2004 you must pack all possible deductions into 2004.

Mail That Check! Pay a deductible expense by check, and it's counted when you *release* the check, no matter when it's *cash*ed.

Credit Cards. The expense counts when you *sign* the credit slip, not when you *pay*.

Medical Expense. Medical must exceed 7.5% of your gross income to help you. If you pass the limit, don't miss a thing. Fees to any licensed health care professional. Laser eye surgery. Prescription drugs qualify. **Not** an over-the-counter remedy, self-prescribed cure, or food supplement. Yes, for medical supply, therapy, or ambulance. If you have insurance, claim only the amounts you actually pay out of pocket.

Taxes. Consider paying one extra installment of property tax. If you will owe state income tax, consider paying in December.

Contributions. Look for both cash and merchandise gifts. Dig out your canceled checks. Try to recall cash gifts at work or the front door. When you buy cookies or candy from youth groups about 50% of what you spend is deductible – the rest is the value of the merchandise.

Needed Receipts. For a single gift of \$250 or more, a receipt from the charity is a *must*. If you are audited later, your canceled check alone **WILL NOT** be enough!

Noncash. Is it time to clean out the garage? Don't wait until January to give away those discards, or you won't see the tax savings for over a year. Make a list of the items plus your estimate of value. A snapshot of the items can be most helpful.

For gifts totaling \$250 or more, a receipt is a *must*. If your gift reaches \$5,000 or more you'll need an appraisal as well.

Job Expenses. Expenses for job or investments are called "miscellaneous". You may deduct them to the extent they exceed 2% of your gross income. Above this

"floor" everything helps. Look for dues, job search, employment agency fees, books, publications, job-related education, job supplies, business meals and entertainment, business gifts. Be sure to include any mileage associated with the costs.

Investment Expense. This includes investment books, publications, account fees on investments. Investment counseling or planning fees are also deductible.

Special Transactions. Find all records for any special sale, purchase, or investment. For any real estate sale or purchase the settlement statement is crucial.

Refinancing. I need to see all the paperwork. Again, the official settlement statement is crucial.

Businesses. Stock up on supplies now. Look at your business cards, stationery, and office supplies. Are your bills paid? Need equipment? Buy in December (and *use* the equipment). You get the tax savings now. We can deduct your health insurance costs if you are self-employed. Find the premiums.

Landlords. Are there last-minute repairs or painting to do? Property taxes and insurance paid up? List your driving for the property. A rent check received in December must be counted even if you don't cash it until January.

Mileage Deductions. With business expenses, you may deduct the related driving. This year we get 37.5¢ per mile. Every 266 miles you claim is a \$100 deduction.


Parking, Tolls, Taxes. These may be claimed in addition to the amounts above. Interest on a car loan may be claimed by those who are self-employed, but not by employees.


Special Note – Equipment. We normally depreciate equipment which will last more than one year. 2004 is the last year for a "bonus" which allows faster write-off. You may see advertising that urges you to buy "before it's too late". If you *need* the equipment, buy it. The so-called "bonus" is not additional write-off. It's simply getting your deductions more quickly.

January – Time To Get Ready!


Preparing your tax information is simple if you spend a few minutes each week. Start collecting the records and keep them in a special place. Review weekly.


Many tax records show up in your January mail. Usually IRS gets a copy too. Don't miss any of these!


 **W-2s.** Read them carefully. Contact employer if there is a problem. If one is missing after January, contact employer. If you can't locate the employer, you'll need to collect your pay stubs.

 **1099s.** There should be a 1099-INT or 1099-DIV for each account which pays interest or dividends. Even tax-exempt interest must be listed on your return.

Other 1099s. A real estate sale means a 1099-S. Stock sales yield 1099-B. Pensions - 1099-R. There are several others. Watch for the words "Important Tax Information Enclosed" on the envelope.

 **Form 1098.** That's your mortgage interest. Banks use this form. With a private loan, you need the payment book or a statement from lender to verify the amount.

 **Other Income.** Look for other reports of income. You may see forms for state tax refunds, unemployment income, prizes, gambling wins, or rents you collect. Read each of these carefully.

 **Your Records.** Check your own records carefully for both income and deductions. Review your calendar and your check register. Look back over the year in your mind. I'd prefer that you have receipts for all expenses, but if you recall paying a deductible expense it should be claimed.

Start compiling the information right away. Don't wait until the day before you give the information to me. Make careful lists of missing items. Write down any questions you might have for me.

Take a few minutes each week to review your information. Short reviews help you remember items you might miss. Your subconscious mind will dig up things you forgot. It's your money at stake here – protect it!

Need To Send 1099s?

You may need to send Form 1099 to someone else. There are two cases:

- **Business/Rental.** You must report payments for services.
- **"Nominee" amounts.** If you are named as receiving income, but part or all of the income really belongs to someone else, you are a nominee.

You must issue Form 1099 to the other party by January 31. IRS wants a copy by February 28. There are penalties for not sending them!

Business/Rental. If you paid \$600 or more to anyone during 2004 you may need to issue the form. Look at "business" expenses only. Expenses in your personal life are not reported. Nor are payments to a corporation.

Some bills show both labor and materials. If *any* part of the payment was for services, report the *total* amount on Form 1099. Paying for merchandise alone doesn't count. Rent you pay to an agent instead of to a landlord is excepted. Look for repairs, painters, consultants, builders and the like.

You need name, address, and Tax I.D. Number for these people. Call them or send Form W-9 to request the information. If someone uses their own name, they should give you their Social Security Number (like 555-55-5555). If they give a business name, you should see an Employer I.D. Number (like 55-555555).

Nominees. Limits are lower. If you pay \$10 or more to another, you must file the form. You file the same type of 1099 as you received, but you are filing as a "middle man".

Getting the Forms. I can help, or you can get forms from IRS. If you need my help, please call early! My tax season is hectic and the deadline comes quickly. You can get forms from IRS at 1-800-829-3676. Or you can download them at www.irs.gov. You need Form 1099-MISC and Form 1096 as a cover sheet.

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This publication has been sent to you by your tax advisor for informational purposes only. The opinions are generalizations and may not apply to all taxpayers.

Got it All?

Here's a list of items frequently missed. Check it against your list.

- Refinances.** I need to see the settlement statement. Maybe it's best to bring all the paperwork.
- Child Care Expenses.** I need full name, address, telephone and I.D. number of care providers.
- Estimated Tax Payments.** If you paid estimates, I need dates and amounts for all payments. Look in your check register near April 15, June 15, and September 15 of 2004, and January 15 of 2005. The January 2004 payment was claimed on your last return.
- Sales of Property.** The most important thing is the settlement statement. Bring all the paperwork.
- Student Loans.** Form 1098-E reports your interest. I need this plus information about the nature of the loan.
- College Tuition.** Form 1098-T lists college tuition paid. I need the form and full details on who took the courses. This may help you get valuable tax credits or deductions.
- Sales of Stock.** Brokers send Form 1099-B to show sale price. I need the original purchase price and date. Can you find the "buy" slip?
- Business Records.** Please separate purchases of major equipment from other supplies.
- Contributions.** Remember – any single contribution of \$250 or more requires a receipt. We don't attach them to the return, but you must keep them.
- Sales Tax.** Remember the new law? If you bought a vehicle, boat, or RV, find the contract. The sales tax might help your deductions.
- Employer Reimbursements.** If your employer reimburses any of your expenses we need records to insure we claim only the excess.
- Partnership Information.** Schedule K-1 from partnerships always seem to be late. Don't worry. Let's do the rest, and be ready to go when the K-1 arrives.
- Social Security Benefits.** Be sure you have the actual Form 1099-SSA. We must declare the GROSS amount you were paid, not your net monthly benefit.

We'll Print
Your Return Address
And
Postal Endorsement

Mailing Flap

You Add Postage
Or
We'll Print Your
Bulk Permit

You Add Your Client Address

Tips For You

Saving For Retirement? If you are trying to sock away enough for a comfortable retirement there's good news for 2005. The amount you can contribute goes up in January. If you have a 401(k), 403(b), or 457 plan your maximum goes from \$13,000 to \$14,000. If you will be age 50 or older by the end of 2005 you may contribute an additional \$4,000. SIMPLE plans go from \$9,000 to \$10,000 with an additional \$2,000 for those 50 or older. Self-employed people with SEP plans can defer up to \$42,000, plus \$4,000 for age 50 and older. IRA limits increase from \$3,000 to \$4,000, with an extra \$500 for the age 50 group.

Lawsuit Awards – New Law. When you win a suit over a physical injury, the award is tax-free. Other awards are taxable, but there's a trap in the attorney fees. They must be deducted separately and can trigger alternative minimum tax. New law says the fees are deducted directly from the award for suits settled after October 22, 2004. However, this will apply only for suits claiming unlawful discrimination.

Hybrid Car Deduction Saved. The \$2,000 deduction for first buyers of hybrid vehicles was scheduled to begin phase-out in 2004. The full \$2,000 deduction will be allowed in both 2004 and 2005.

Social Security Update. If you receive Social Security your January benefit check will increase by 2.7%. That's \$27 on a \$1,000 benefit. You'll only be able to spend about half the increase, though. Your monthly Medicare B premium will increase from \$66.60 to \$78.20. That's \$11.60 of your increase gone before you see the check.

2005 Wage Base to \$90,000. Workers will pay full social security taxes on the first \$90,000 of income in 2005. At this level, employees will pay a whopping \$5,580 – and employer will match this dollar for dollar. Self-employed persons are considered to be their own employer, so they can pay the full \$11,160. Above the \$90,000 ceiling only the 1.45% Medicare tax is imposed.

Two New Rules – Home Sales. The October law added a change. If you acquired the property in a Section 1031 tax-deferred exchange, the normal 2-year holding period before you may claim an exclusion of gain is increased to 5 years.

Military personnel got a big help in a late-2003 change that bears repeating. While on "qualified extended duty" you may exclude up to 10 years of time from the normal 5-year look-back period upon sale. Effectively, instead of needing to show the property was your principal residence for two years within the last 5 year, you might qualify with 2 years within the last 15 years!

Happy New Year!

Over the years you have become nearly members of my family. As 2004 draws to a close I offer the same wishes I have for my family and best friends. I hope 2005 will bring peace, contentment, and prosperity to you and to your loved ones.

Happy 2005!

Your Tax Calendar

Dec 31	A check mailed today counts for 2004. Last chance for deductions! State estimated tax paid today is deductible on 2004 Federal return.
Jan 18	4 th quarter estimated tax payments due.
Jan 31	Employers – Quarterly payroll & FUTA due. W-2's and 1099's due to recipients.
Feb 28	W-2's and 1099's due to IRS.
April 15	2004 tax returns due. Last day for 2004 IRA contributions.