TaxTips

Keeping you informed...

Winter 2003/2004

Child Tax Credit

Did you receive a check this summer?

When Congress increased the child tax credit from $600 to $1,000 with the passage of the last tax bill, it decided to send the increase as an advance refund. The refund was sent to taxpayers who claimed eligible children as dependents in 2002.

It is important that the amount of the advance refund you received is communicated to your tax preparer. The amount is needed to accurately compute the amount of the child tax credit you are eligible for on your 2003 tax return.

If you did not receive an advance refund this summer, don't worry. You will be allowed to claim up to the full amount when you file your 2003 tax return.

Changes to the Tax Law Benefit Married Taxpayers

It may be advantageous to take the standard deduction every other year

For 2003 and 2004, the standard deduction for married couples will double to twice the amount of the standard deduction for single taxpayers. This temporary change may make it more advantageous for you to hold off itemizing your deductions every other year. You can do this by grouping certain deductions, such as charitable contributions and property taxes, in years that you itemize. In 2003, the standard deduction for taxpayers who file a joint return increases to $9,500.

Not All Your Income is Taxable

Have you received any nontaxable income?

There are certain types of income that are not taxed and do not have to be reported on your tax return. These include child support payments, military allowances, veteran's benefits, welfare benefits, Social Security Supplemental Income (SSI) benefits, and workers' compensation. Also, a cash rebate that you received for a new car purchase is not considered taxable income.

NATP®
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Deduction for Classroom Materials

Teachers get a break

Teachers, instructors, counselors, principals, and aides who work at least 900 hours during a school year in an elementary or secondary school can take a deduction on Form 1040, even if they do not use Schedule A to itemize their deductions. The deduction can be up to $250 of expenses for books, supplies, computer equipment (including software and services), and materials used in the classroom. Previously, these expenses were deductible only as a miscellaneous itemized deduction subject to the 2% of adjusted gross income limit. This deduction will not apply after 2003 unless Congress votes to extend this break.

Maximize Your Retirement Savings

Are you age 50 or older?

If you are age 50 or older and you have earned income, you are permitted to contribute an additional $500 to your traditional IRA or Roth IRA. For 2003, your total contribution could be as much as $3,500. Limitations on contributions and deductibility to your traditional IRA apply if your income exceeds certain levels or you or your spouse participate in a qualified employer provided retirement plan. Income levels affect contributions to your Roth IRA as well.

Additional contributions can be made to §401(k), §403(b), or §457 plans. In 2003, you can set aside an extra $2,000. This increase can bring your total salary deferral into a §401(k) to $14,000.

Miscellaneous Itemized Deductions

Did you incur any of these often overlooked deductions?

Miscellaneous itemized deductions are often the most difficult to remember at tax time. Plus, only your miscellaneous deductions that exceed 2% of your adjusted gross income are deductible. Did you incur any of the following expenses in 2003?

- Depreciation on a self-owned computer or cellular telephone required to do your job.
- Dues to chambers of commerce, professional societies, and unions.
- Education that is employment-related.
- Home office or part of your home used regularly and exclusively in your work.
- Job-search expenses in your present occupation.
- Legal fees related to doing or keeping your job, and protecting or collecting taxable income.
- Licenses and regulatory fees, as well as occupational taxes.
- Malpractice insurance premiums.
- Medical examinations required by an employer.
- Passport for a business trip.
- Subscriptions to professional journals and trade magazines related to your work.
- Tools and supplies used in your work.
- Travel, transportation, entertainment, and gift expenses related to your work.
- Work clothes and uniforms and their upkeep costs.
- Tax preparation fees.
- Union dues.
- Safety equipment used for your work.

The expenses must have been required to carry out the job for which you were hired and must be what the IRS calls "ordinary and necessary." This means the item or service is common and accepted in that line of work and is appropriate and helpful to the job.

Are You a Working Student?

You may not be subject to income tax withholding

Working students may be exempt from withholding if:

- They can be claimed as a dependent (usually on a parent's return);
- Their total 2003 income is not over $4,750;
- Their unearned income (interest, dividends, etc.) does not exceed $250; and
- They had no income tax liability for 2002.

Social security and medicare taxes will still need to be withheld, but skipping unnecessary income tax withholding will put more money in your pocket now. If you receive customer tips, those tips are taxable. Keep track of the amounts, include them on your tax return, and report them to your employer by the middle of the following month if they total $20 or more.

Tax Law Changes Lower Tax Rates on Capital Gains

Lower rates mean savings for you

Selling your assets at a gain will save you tax dollars. The recent changes to the taxation of capital gains mean you will pay less tax when you sell property at a gain. The maximum tax rate has been lowered to 15%, or 5% if you are in a lower tax bracket. There is a catch, however. The lower rates apply only to sales of assets that took place after May 5, 2003. If you sold property using the installment method and you received payments in 2003, the payments you received after May 5, 2003 will qualify for the lower rates.

Dividend Income Receives Tax Break

Lower rates mean savings for you

The tax law changes enacted in May 2003 changed the way certain dividends are taxed.

- Dividends received by an individual shareholder from a domestic (U.S.) or qualified foreign corporation will be taxed in the same manner as capital gain income. This translates to a 15% tax rate for most taxpayers and a 5% tax rate for taxpayers at lower income levels. This applies for both regular tax and alternative minimum tax.
- This provision is retroactive for dividends you received as of January 1, 2003, but it is temporary, terminating on December 31, 2008.

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QUIK TIPS

1 Double check the accuracy of the social security numbers for you, your spouse, and your dependents. Numbers that do not match the Social Security Administration's database will result in rejected or delayed tax refunds.

2 You can claim the interest portion of a December mortgage payment mailed during the final days of the year, even if it doesn't show up on the lender's year-end statement. As long as the check was in the mail by December 31, you get a 2003 deduction, even if the check isn't cashed until 2004.

3 If you took out a loan to make a contribution to your IRA, the interest is deductible as investment interest on Schedule A.

4 The costs for weight-loss programs can be deducted as a medical expense if the taxpayer is diagnosed by a physician as obese or suffers from some other ailment such as hypertension, where weight loss would relieve the medical condition.

5 For 2003 and 2004, the alternative minimum tax exemption amount is increased to $58,000 for married taxpayers and to $40,250 for unmarried taxpayers.

6 If a husband and wife file a joint return, their gambling winnings and losses are pooled so that the losses of one spouse are deductible against the winnings of the other, up to the amount of their combined winnings.

7 If you receive property in exchange for services you perform, you must include the property's fair market value (FMV) in income. The amount you include in income becomes the basis of the property if you decide later to sell that property.

8 If you rented your vacation home for less than 15 days, the income you received is not taxable. However, the expenses related to the income are not deductible.

9 If your employer maintains a flexible spending plan that reimburses you for medical expenses, you may now get reimbursed for over-the-counter drugs. However, over-the-counter drugs are still not allowed as a medical expense deduction on Schedule A.

- The 5% rate terminates on December 31, 2007 and falls to 0% for 2008. This one-year break applies only if you are in the 10% or 15% tax brackets.
- Certain types of dividends are specifically excluded from the definition of "qualified dividend income" for purposes of the new law, including:
  - ✔ Dividends paid from a corporation exempt from tax.
  - ✔ Dividends paid on deposits in a mutual savings bank, credit union, savings and loan, etc.
  - ✔ Dividends paid on stock held in an Employee Stock Ownership Plan (ESOP).
  - ✔ Dividends that fail to meet the revised holding period.
  - ✔ Dividends are to be treated as investment income (if the taxpayer elects) for purposes of the limits for the investment interest deduction. What this means is that you will not be allowed both the benefit of the lower tax rates and the treatment of this dividend income as net investment income for purposes of deducting investment interest.

Shifting Income to Your Children

Taking advantage of your child's lower tax bracket

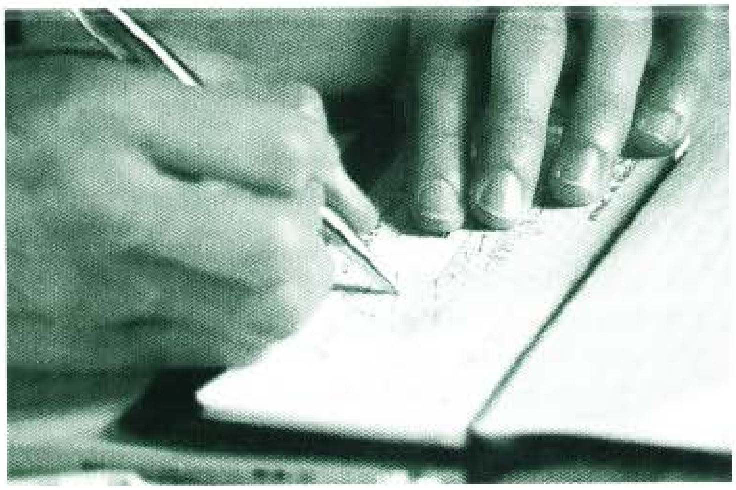
The strategy of putting investment property in your children's names can still work for you even though your child may be under the age of 14 and subject to the kiddie tax. First, the kiddie tax does not apply if your child reaches the age of 14 before the end of the year. Even then, chances are your child will be in a lower tax bracket than you are. The long-term tax savings will help when the time comes to start paying for their college education. Second, current transfers can pay off in later years. You are permitted to gift up to $11,000 annually ($22,000 if you are married) to each individual without incurring a gift tax liability. This allows you to gradually transfer a sizable portion of your estate to family members who are in a lower tax bracket.

If you own your own business, you can hire your children to work for you. Earned income is not subject to the kiddie tax rules, and paying them a wage offers another means for transferring taxable income to a lower tax bracket family member.

If your child is under the age of 14, unearned income such as interest, dividends, and gains from the sale of property will be taxed at your rate. The first $750 of unearned income is not taxed. The 10% tax rate applies to income between $751 and $1,500, with any excess taxed at your rate.

Charitable Contributions

More than just cash contributions are deductible



Everyone knows that cash contributions given to charities are tax deductable. But did you realize that there are many more things you give during the year that can become a tax write-off?

All those old clothes, dishes, appliances, and other items that you cleaned out of your basement or attic can mean money in your pocket. Instead of throwing them in the garbage, take them to the local thrift store. Be sure to ask for a receipt. The fair market value of the items is a charitable contribution. How many times do you use your car to transport the youth group to an outing, or make deliveries for the local food pantry? You are allowed to deduct 14 cents for each mile you drive for charitable purposes. In addition, any out-of-pocket expenses you incur for a charity qualifies as a charitable contribution.