

Taxlink 2003 Winter Newsletter

December 1st, 2003

Quick Tips:

- If you took out a loan to make a contribution to your IRA, the interest is deductible as investment interest on Schedule A.
- 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.
- 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.
- 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.
- If you are self-employed, you are allowed a deduction as an adjustment to income for insurance costs incurred for medical care as long as you are not eligible to participate in another employer-sponsored plan. For 2003, 100% of the cost is deductible.
- The wage base for computing the social security tax (OASDI) for 2003 is \$87,000. The base also applies to OASDI for self-employment income. The Medicare (HI) tax is computed on the total wages or self-employment income.
- Keogh plans must be set up before the end of your tax year. You are permitted to fund the plan anytime up until the due date, plus extensions, for filing your tax return.
- A SEP plan can be set up and funded by the due date, plus extensions, for your tax return. The contributions you make to the plan can be deducted on your 2003 return even if they are made in 2004.
- The standard mileage rate for business use automobiles is 36 cents in 2003. The standard mileage rate is allowed in lieu of deducting your actual expenses, and can be used whether you own or lease your automobile.
- Did you start a new business this year? There are many costs associated with the start-up of a business that can be deducted once your business opens. To qualify as a start-up cost, the expense must be one that you could deduct if you were already in business. Examples include travel to suppliers, training for new employees, advertising, utilities, and other pre-opening expenses. The total of all these expenses is deducted over a period of not less than 60 months.

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.

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.

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 participates 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.
- 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.

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.
- 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 that are 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.

Do You Work From Home?

Your expenses may be deductible

If you are self-employed and you use a portion of your home for business, you may be able to deduct the associated costs.

- Your home office area must be used regularly and exclusively for your business needs. You can't set up a computer in your den, input invoices sporadically, and then claim that room as your home office.
- The business part of your home must be either your principal place of business or where you meet or deal with patients, clients, or customers in the normal course of your business. A separate, detached structure such as a garage or guesthouse that you use for business also may qualify as a home office.
- If your home office is used exclusively and regularly for the administrative or management activities of your business, it qualifies as a home office. Billing operations, keeping your books and records, ordering supplies, or setting up appointments qualify as administrative duties.

If you meet all the requirements to claim a home office, some of the expenses you can deduct include a portion of your real estate taxes, deductible mortgage interest, rent, utilities, insurance, depreciation, painting, and repairs. The total amount you can deduct depends on the percentage of your home used for business. Keep in mind, your deduction will be limited if the income from your business is less than all your business expenses.

Making Improvements to Rental Property

What qualifies as a current deduction and what does not?

It is often difficult to determine which repairs and improvements you made to rental property qualify as a current expense, and which must be depreciated. There is a general rule stating that if the repair merely returns the property to its normal working condition, it is most likely a current expense. Examples of these types of repairs include replacing light fixtures, windowpanes, torn shingles, or other incidental repairs to your property.

Major improvements such as a new roof, siding, a driveway, extensive renovation, or a new addition are capitalized and depreciated over the life of the building. Other improvements like new carpeting, furnaces, and air conditioners are also depreciated, but over a shorter time period.

Section 179 Expensing

Tax law changes increase your options

There are new rules for §179 expensing that take effect in tax years beginning after December 31, 2002.

- For 2003, taxpayers can expense up to \$100,000 in property purchased for business use. This is an increase from the \$24,000 limit allowed in 2002. You are allowed the full \$100,000 even if you purchased equipment for your business on the last day of your tax year.
- For 2003 through 2005, off-the-shelf computer software is eligible for expensing under §179. This change allows you to write off the cost in one year as opposed to stretching your deduction over three years.
- Unless §179 is further amended for years after 2005, these new provisions will revert back to prior law for the 2006 tax year. This means that off-the-shelf computer software will no longer be eligible for expensing and taxpayers will no longer be able to revoke the §179 election without IRS consent.

Employer Identification Numbers

When do you need one?

There are several instances when you will need to apply for a federal employer identification number (EIN). The most common instance is when you are operating a business and you have employees. If you are operating a sole proprietorship and you do not have any employees, your social security number is all you need. If you are a sole proprietor and you currently have an EIN, you will need to get a new one if you convert to a partnership or corporation. If you convert to a limited liability company, you will only need a new EIN if you choose to be taxed as a corporation or partnership.

You will not need a new EIN if you only change the name or location of your business, or if you operate at more than one business location. You may not transfer or sell your EIN, even if you are transferring your business to a spouse or other family member.