



# EXTRA

The Informative Dispatch

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## Planning to Increase After Tax Cash

*We have some year-end strategies to reduce 2002 taxes that we want to pass on to you. However, to maximize annual benefits, effective planning is ongoing and best if put into practice at the beginning of each tax year. Acting now can help save some 2002 tax dollars; put into practice at the beginning of 2003, can result in potential saving in 2003 and beyond.*

*The true value of planning lies not in tax reduction but in the increase of after tax cash.*

This newsletter details year-end strategies, provides information, and *most* importantly, points out ways to increase after tax cash flow.

Joint return filers and single taxpayers hit the maximum tax bracket of 38.6% in 2002 at a taxable income level of \$307,050.

Appreciated securities held for more than a year, gifted to age 14 and older children, and sold in 2002 may be subject to a federal capital gain rate of only 8%.

**Gifts up to \$11,000** can be made to any person in 2002 free of gift tax.

Capital gains and losses from all sources are grouped together. If it makes economic sense, sell securities, which have diminished in value (*i.e.*, losers) by December 31. Resulting loss can offset capital gains from stock sales, real estate sales, etc. Especially valuable strategy if capital gains are short-term or derived from sale of collectibles.

There are "family" tax dollars to be saved by shifting income to children. In 2002, under age 14 children pay 5% on the first \$1,500 of ordinary income; age 14 and older children pay 10% or less on the first \$6,000 of taxable income and 15% on the next \$21,950 of income; 15% bracket increases in 2003. Five percent, 10% and 15% is far better than the parent's rate of 40%.

The maximum 40% rate equals 38.6% (top bracket) plus 38.6% x 3% (itemized deduction phase out %). Could be higher if you factor in exemption phase-out!

Family limited partnerships are a nice way to shift income to children while maintaining control over principal.

**Childcare credit maximums go up in 2003.** Due to phase-outs, high-income taxpayers (AGI over \$30,000) will be eligible for a maximum credit of \$600 (one child) or \$1,200 (2 or more); up from \$480 and \$960 in 2002.

**Most efficient** way to pay childcare is through an employer sponsored "129 Plan." Up to \$5,000 of W-2 compensation may be used to pay childcare "tax free" (*i.e.*, not subject to income or FICA taxes). In addition, if you pay childcare of \$6,000 or more, you may take advantage of this exclusion and obtain a \$200 credit!

More people may be eligible for an **increased adoption credit**. Taxpayer's with AGI of \$150,000 or less may be eligible for a \$10,000 credit. However, partial credit available if AGI exceeds \$150,000 but is less than \$190,000.

In a divorce situation, award of a “dependent” may mean a lot more than potentially obtaining a \$3,000 exemption deduction. Parent of dependent may only claim childcare credit, child tax credit and education credits.

High state and local tax expense, employee business expenses, investment management expenses, equity line interest, incentive stock options, and other adjustments may subject you to the alternative minimum tax. Employ **AMT** avoidance strategies so as not to lose benefit of these deductions.

Watch refinancing, resulting new debt could cause **AMT** problems.

Use interfamily loans to increase cash flow, reduce financing costs, shift income, and reduce taxes.

Possibly obtain low cost financing through “margin” loans.

Convert equity line interest to business interest expense by tracing the use of related funds.

**Beginning in 2003**, standard mileage reimbursement rate decreases from 36.5¢ per mile to 36¢.

Are you satisfied with your credit cards? Do you have the best available interest rate? Do you have frequent flyer miles program? Check out [www.bankrate.com](http://www.bankrate.com) and find out.

**TEACHERS:** Eligible educators may obtain an “above the line” \$250 deduction for unreimbursed expenses (books, supplies, software, etc.). Eligible educator equals kindergarten through grade 12. Sorry college professors!

If correctly done, you may access **IRA** funds before incurring 10% penalty before age 59½.

**Don't forget** to consider “minimum” retirement plan (including **IRA**) distribution by December 31 if over age 70½. Use new tables (reduce required distribution amount).

Take advantage of all available tax advantaged ways to save, **IRA**, **ROTH IRA**, **401K Plan**, **Coverdale Education IRAs**, **Section 529 Plans**.

Limited funds? Then prioritize based on your individual circumstances.

Take advantage of employer matching **401K Plans**. Where else can you obtain a guaranteed, risk free return? If employer matches 100% that is a 100% immediate return, where can you beat that (risk free)?

**Who has the best 529 Plan for you?** Visit [www.savingforcollege.com](http://www.savingforcollege.com) and get more information than you could possibly need.

Use “rollover” techniques to enhance your child’s financial aid prospects!

**Beginning in 2003**, medical premiums paid by self-employed individual are 100% deductible (versus 70% in 2002). If possible delay December payment (clearly do not prepay January 2003).

**IRS** vows dramatically to increase audits beginning with 2002 returns.

Make your charitable contributions by way of appreciated securities. Obtain fair market value deduction and avoid capital gain recognition.

Remember to **obtain** your “**receipt**” from charity for contributions of \$250 or more.

Paying income taxes with credit cards to obtain frequent flyer miles, does not come without a cost. Taxpayer (NOT **IRS**) must pay credit card fee. Make sure fee is less than the cost of the flight the “free” miles will acquire.

Owners of closely held corporations may obtain a 100% deduction for the cost of company purchased long-term care insurance. No discrimination rules apply. Company could choose only to cover owner(s).

**IRA** (including **ROTH IRA**) contribution limit for 2002, 2003, and 2004 is \$3,000, \$3,500 of over age 50.

“Non working spouse” (*i.e.*, tax term) may make a **deductible** \$3,000 **IRA** contribution if **AGI** less than \$150,000.

If **AGI** less than \$150,000 on joint return consider \$3,000 **ROTH IRA's** – Beauty of **ROTH** is that you can pull out principal **anytime** tax-free.

Pay child as domestic employee (*i.e.*, cut grass, paint deck, etc.).

If under age 21, may avoid **FICA** and income tax. Use proceeds to fund **ROTH IRA**.

**ROTH IRA declined in value**. Terminate **ROTH** and possibly create tax deduction.

Shift education credits to children if your **AGI** precludes use by you.

**Year 2002, 401K maximum is \$11,000**; up to \$12,000 in 2003. Taxpayers over age 50 may defer additional \$1,000 in 2002, \$2,000 in 2003.

Take advantage of new sole proprietor (Schedule C) profit sharing/**401K Plan**, may be able to shelter as much as \$41,000. Great strategy for certain, businesses, hire spouse, and increase benefit by \$11,000 plus 25% of spouse compensation.

**Part-Timers**: You may be able to defer tax on 100% of your salary if employer sponsors a 401K Plan.

It may be more beneficial to invest \$3,000 in good growth stock than on a nondeductible **IRA**.

Use “Family” members to leverage annual contributions to **529 Plans** and Coverdale Education savings accounts as well as enhancing possibility of college financial aid.

Are you thinking of buying a company auto (*i.e.*, cost in excess of \$40,000)? Wait until January 2003. A \$50,000 car purchased in December 2002 will cost \$1,500 more than if purchased in January 2003 when the \$1,500 luxury tax disappears.

“Protection” against under payment penalty is less costly in 2003. Need only to pay in 110% of 2002 tax to avoid potential penalty (versus having to pay 112% of 2001 tax in 2002).

Social Security Wage base continues to rise. In 2003, first \$87,000 subject to 6.2 % **OASDI** tax versus \$84,900 in 2002.

Equipment can substantially be written off if purchased and placed in service before year-end. For example, you may be able to write off over 71% of a \$50,000 asset. That's about \$35,500!

Section 179 (asset write off) maximum for 2002 is \$24,000, in 2003, \$25,000.

Maximize depreciation to create net operating loss that may be carried back 5 years to recapture prior year taxes.

Obtain rapid write off for land improvements and qualified leasehold improvements. Properly structured, you may be able to expense 30% of an asset in year one versus depreciating this same amount over 39-years. Time value here!

Write off business automobiles more rapidly in year one. Maximum depreciation for 2002 and 2003 purchases increased to \$7,660, versus normally allowed \$3,060.

Restaurants should take advantage of new “smallwares” provision, as it may be possible to expense cost of acquiring pots, pans, dishes, glassware, etc. in year of purchase.

Watch out for “wash sale.” If stock sold at a loss, do not purchase same stock 30 days before or 30 days after date of sale; violate this rule and lose current year loss.

If not on **AMT**, prepay state tax (*i.e.*, December 2002 versus January 15, 2003), to secure 2002 deduction – same for January 2003 property tax bill.

