

Tax Tips

Keeping you informed...

Summer 2005

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Was Your Tax Refund Too High or Low?

Adjusting your withholding solves the problem

Now that you've filed your 2004 tax return, you may be asking how you can adjust your refund for next year. Adjusting the amount of your refund, or ensuring you have no balance due, is as easy as adjusting your withholding from your paycheck. You can file a revised Form W-4 with your employer at any time to either increase or decrease the number of exemptions you claim. Increasing your exemptions results in less tax being withheld from your paycheck each pay period. Decreasing your exemptions results in the opposite.

If you are self-employed, a mid-year review with your tax preparer may be in order. The amount of estimated taxes you are required to pay may need adjusting to reflect an increase in your income or unexpected expenses. Taking the time to make those adjustments now will prevent unwanted surprises when it comes time to file your 2005 tax return.

Proving Deductions Without Canceled Checks

Careful recordkeeping becomes more important than ever

The Check Clearing for the 21st Century Act (Check 21) became effective on October 28, 2004. This means that your bank won't be returning your canceled checks. Check 21 allows your bank to pare down each of your checks and create a new electronic substitute check. After doing this, your bank destroys your original check.

How does Check 21 change the way you're able to prove an expense that may entitle you to a tax deduction or credit? The short answer is that you'll need to keep your past bank



statements in good order. The IRS says that it will accept bank statements that contain images of canceled checks and/or substitute checks. To be used as proof, an account statement must show the check number, amount, payee's name, and the date the check was posted.

In order to keep track of your payments more easily for tax purposes, you should also maintain a careful check register. That way, you'll know on which bank statement to look if the IRS ever audits you.



IRA to Roth Conversion

Tax strategy saves you money

You may be eligible to convert your existing IRA to a Roth IRA and realize significant tax savings by doing so. Taxpayers are eligible to make this conversion if their adjusted gross income does not exceed \$100,000 and they do not file their return as “married, filing separately.”

Some of the benefits of converting your traditional IRA to a Roth IRA include:

- Qualified distributions from a Roth IRA are tax free;
- Nonqualified distributions of contributions from a Roth IRA are tax free five years after conversion;
- Roth IRA balances can accumulate tax free indefinitely; and
- Roth IRAs are not subject to the required minimum distribution rules for taxpayers who have reached age 70½.

There is a cost to converting a traditional IRA to a Roth IRA, however. The IRS requires you to include any converted amount in your taxable income for the year, making it subject to regular income tax rates.

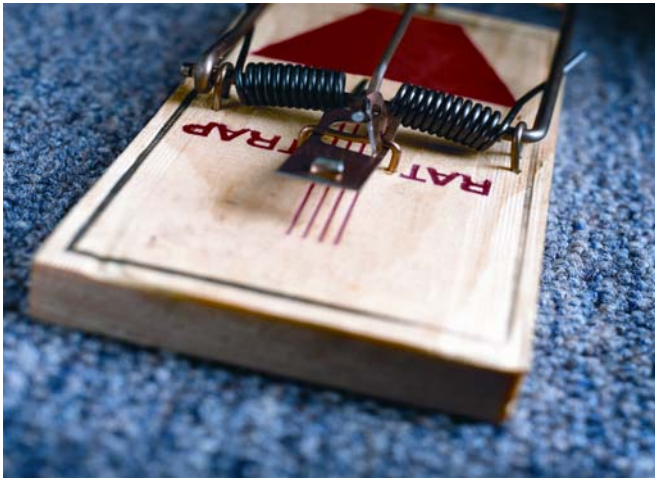
A Simplified Employee Pension (SEP) or a Savings Incentive Match Plan for Employees (SIMPLE) may also be converted to a Roth IRA. There are additional restrictions on conversions from SEPs or SIMPLEs. For example, you cannot convert a SIMPLE IRA to a Roth IRA within the first two years of participation in the SIMPLE plan. Once you make a conversion from a SEP or SIMPLE IRA, you cannot convert any future contributions to the SEP or SIMPLE to a Roth IRA.

How Generous Are You?

Paying expenses for others won't get you a deduction

Often we are moved to help out family and friends by paying some of their expenses. Did you know that the IRS won't allow a deduction on your tax return for the amount you pay? For example, if you pay another person's mortgage payment or property tax, you are not entitled to deduct these amounts on your return because you are not liable for the payment. Likewise, the person for whom you made the payment is not allowed the deduction because he or she did not make the payment.

A good alternative is to make a gift of cash to the individual and have them make the payment on their own. This way, the deduction is not lost. Keep in mind, however, that if the amount you give is in excess of \$11,000 per year to one individual, the IRS requires you to file a gift tax return.



Will You Be Hit With Alternative Minimum Tax?

Tips to avoid an unexpected trap

Each year, more and more middle-income taxpayers are hit with alternative minimum tax (AMT). Although it wasn't the intent of lawmakers, average taxpayers are falling into the AMT trap at an alarming rate. To reduce the possibility of being affected by the AMT, you may want to consider timing your income and deductions, deferring certain items to a future year, and accelerating others into the current year. As a general rule, it's best to accelerate items of income into AMT years and postpone deductions into non-AMT years.

Depending on your exposure to the AMT in 2005, some possible tax planning strategies include:

- Delaying payment of certain items, such as state and local income taxes, property taxes, medical expenses, and miscellaneous expenses (provided this does not impair your credit status or business standing or cause you to incur late charges);
- Postponing charitable contributions;
- Avoiding the exercise of incentive stock options;
- If large long-term capital gains will affect your AMT, delaying the asset sale until after year-end or spreading the gain over a number of years by using an installment sale; and
- Making use of any AMT credit, if applicable.

QUICK TIPS

1 If your child has earned income from a summer job, you may want to consider opening an IRA for him or her. There is no minimum age for contributing to an IRA. All that is required is that the person making the contribution has earned income and has not reached age 70½.

2 An "above-the-line" deduction is available for contributions to Health Savings Accounts (HSA). The IRS limits the deduction to the annual deductible on the qualifying high deductible health plan, but not more than \$2,600 (\$5,150, if family coverage). These limits are \$500 higher if the taxpayer is age 55 or older (\$500 each if both spouses are 55 or older). You cannot contribute to an HSA starting the first month you are enrolled in Medicare.

3 For 2005, educators may still deduct up to \$250 of expenses paid for purchases of books and classroom supplies as an adjustment to gross income. After this year, the deduction expires unless a change in the law extends it.

4 In 2005, you may earn up to \$12,000 per year (\$1,000 per month) before any of your Social Security benefits are reduced, provided you are under the full retirement age. In the year you reach the full retirement age, you may earn up to \$31,800 annually (\$2,650 per month). The full retirement age is 65 years and 4 months if you were born in 1939, and age 65 and 6 months if you were born in 1940. There is no limit on earnings beginning the month you reach full retirement age.

5 For 2005, you may contribute up to \$4,000 to your Roth or traditional IRA. This amount remains at \$4,000 for 2006 and 2007, and increases to \$5,000 starting in 2008. If you will be at least 50 years old before the end of this year, you may make additional "catch-up" contributions of \$500 to your traditional and Roth IRAs. This amount will increase to \$1,000 starting in 2006. The contribution limits apply to all your IRAs as a whole, not separately. You can contribute any amount to any IRA, provided the limits are not exceeded.

6 Costs incurred for sending your child to day camp this summer may qualify for a tax credit. Parents who incur costs for child care to enable them to work, or look for work, may be eligible for a tax credit. This includes costs for day camp. The costs for overnight camp are not eligible for this credit.





Rebates on New Car Purchases

Is this income taxable?

New car dealerships often entice potential buyers with a cash-back rebate on the purchase of a new car. Perhaps you've wondered whether this income is taxable. In the past, the IRS has unofficially stated that this income was merely a reduction of the purchase price and not included in income. Now, they have issued a ruling specifically stating that rebates received on the purchase of a new vehicle are not taxable.

Sales Tax Deduction

Is this option right for you?

Late last year, Congress passed a new law allowing taxpayers to deduct state sales tax in lieu of state income tax, provided they itemize their deductions. Unless this law is extended, the deduction disappears after this year. Since this new deduction opportunity was enacted so late in the year, many taxpayers were not able to maximize their state sales tax deduction because they did not save their receipts. Instead, they were allowed only to use the amounts found in the tables provided by the IRS. Although you can add sales tax paid on certain items such as a new car, boat, RV, or home-building supplies to the table amount, saving all your receipts may result in a higher deduction.

The sales tax deduction is more advantageous for those living in states where there is no state income tax. In the past, these taxpayers were completely left out of the deduction for state tax.

Noncash Charitable Contributions

Recent changes affect your contribution deduction

For most noncash charitable contributions made after June 3, 2004, you must satisfy certain reporting requirements based on the value of the deduction. For contributions that are more than \$5,000, you must obtain a qualified appraisal and attach Form 8283, Noncash Charitable Contributions, to your tax return. For claimed contributions of more than \$500,000 (if artwork, \$20,000 or more), you must also attach a copy of the appraisal to your tax return.

You should also note that the American Jobs Creation Act of 2004 altered the rules for contributions of used motor vehicles, boats, and planes after December 31, 2004. For donations made after that date, if the claimed value of the donated motor vehicle, boat, or plane exceeds \$500, and the item is sold by the charitable organization, you are limited to the gross proceeds from the sale of that vehicle by the charitable organization.

