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To our Clients and Friends,

It is again time to consider year-end tax planning so I have enclosed your copy of **2003 Year End Tax Planning Tips** to help you. The best time to address tax problems is now, before they end up on your return.

This year's **Planning Tips** has information about the new tax law and some tax-wise investment strategies to consider before year-end, as well as our usual reminders and suggestions for year end planning.

In addition to saving taxes, here are some other areas in which we routinely help clients:

- We help people get through changes in their financial life. Whether it is a divorce, the loss of a job, receiving an inheritance, starting a business, even winning the lottery, we provide people with simple and objective ways of managing what might feel like an overwhelming situation.
- We perform portfolio makeovers. When it comes to investments, most people end up with a collection of mutual funds and stocks that may have been good ideas at the time. We transform that collection into a well-designed portfolio based on understanding a client's investment personality and goals. We then monitor the portfolio regularly in order to keep it that way. Since [Main Street Financial](#) is a *fee-only* registered investment advisor, there are no commissions and you can be assured that the plan is an objective one.
- We help clients address their concerns about providing for their loved ones. It's not just about estate taxes. We also look at any special situations a client's surviving family members will face.

A copy of **2003 Year End Tax Planning Tips** is also available on our website, www.BenwayCPA.com. Feel free to share it with anyone who you think would benefit.

Sincerely,

Charlie

2003 Year End Tax Planning Tips

Note: The purpose of the following **Tips** is to provide you with tax savings ideas that should be pursued further, with individualized advice. In our attempt to give simple explanations of complex tax rules, we may not explain all of the exceptions, conditions, etc. that plague our tax code. This is not meant to provide an exact description of tax laws nor is it meant to provide individual recommendations or advice. If you think any of the following suggestions apply to you, please call us to discuss it further.

General Tax Planning Strategy

Tax planning involves looking across several years at changes in the tax laws and changes in your situation, to identify techniques for paying the least amount of taxes. This is especially important for anyone whose income will change significantly from one year to the next. Anyone with children who hope to qualify for college aid in the next 3 years should start planning now.

The usual strategy, when it comes to tax planning, is to delay paying taxes for as long as allowed. How do you legally put off paying the IRS, without penalties?

The typical approach is to put taxable income off to a later year and to pull deductible expenses into the current year. For example, on the income side, this could involve postponing a bonus to January rather than getting it in December, or selling a profitable investment next year or selling a loser this year. However, you may not have a choice as to when to get your bonus and selling an investment just for tax reasons is usually not a good idea.

On the deduction side, there is a little more control on your part. Many taxpayers have tax-deductible expenses that can be moved between years. Here are some examples: you can make some of your 2004 charitable contributions this year, you can pay property taxes early, and, if you own rental property or a business, you can pay your bills this year.

However, as discussed later, before completing any plans to shift income or deductions between years, please check with us to make sure the Alternative Minimum Tax (AMT) does not negate any anticipated savings.

You should estimate your tax liability for at least two years to make sure any shifting between years really will reduce your overall tax liability.

Flexible Spending Accounts

Under this plan, you are not taxed on wages allocated in advance for dependent care and/or medical and dental expenses. This is an excellent tax savings vehicle that should be used whenever possible. In November or December, employees participating in such a plan must sign up for next year's plan. If you have not already signed up, check with your employer so you don't miss the deadline.

Be careful. If you don't actually use the allocated wages to pay for those benefits, you will forfeit the wages ("use it or lose it"). Therefore, it is important to plan carefully in order to take full advantage of the tax savings without losing any wages.

New this year The IRS will now allow reimbursement for the following: over-the-counter medicine (such as antacids, allergy & cold medicine and pain relievers), laser eye surgery, medical equipment and supplies, reconstructive surgery, and weight loss programs (but not gym memberships).

Also, if you were in a plan during 2003, check now to see if you have used up all your 2003 benefits subject to the "use or lose it" provision.

Watch for the Alternative Minimum Tax

The Alternative Minimum Tax was originally designed to make sure that high-income taxpayers, who took advantage of certain deductions and preferences, did not pay less than a minimum amount of tax. Under the Alternative Minimum Tax system, we perform a separate tax calculation, without taking these deductions and preferences. You pay under whichever method produces the higher tax.

The problem for many taxpayers is that the calculation involves an exemption amount that was never indexed for inflation, so each year it becomes easier for middle-income people to exceed the exemption limits. Also, regular tax rates have dropped, so it is easier for the alternative tax to be the higher of the two.

Although it was intended to avoid abuses, the AMT has become a burden on many middle-income taxpayers, especially in this part of the country where state, local and real estate taxes are high. If you have incentive stock options, a high amount of capital gains, large deductions for state income taxes, large property tax deductions, or high job related expenses, check with us soon to see if AMT will be a problem for you.

Lower Tax on Long-term Capital Gains

The tax on long-term capital gains was reduced from 20% to 15% (for taxpayers in the lower tax brackets, the rate is reduced from 10% to 5%). The new rates take effect for sales after May 5, 2003. As before, the stock must have been held for at least one year.

Lower tax on Dividends

Most dividend income is now taxed at the capital gains rate (15% or 5%), beginning in 2003. However, there are a few exceptions: not all foreign dividends qualify and dividends paid by Real Estate Investment Trusts (REITs) do not qualify. Also, there is a required holding period of 60 days before the ex-dividend date (90 days for preferred dividends).

The favorable rate, which continues until 2009, might cause you to reconsider the make-up of your investment portfolio since dividend-paying stocks now are more attractive than in the past.

Capital Gains Selling Strategies

Generally, gains on the sale of investments are given a more favorable tax rate (maximum 15%) if the investment is held for at least 12 months. This provides some planning opportunities. First, let me point out that we do not recommend selling an investment for tax purposes alone – it has to make sense from an investment and financial planning stand point as well. If you are planning on selling an investment, consider the following:

If you are selling at a profit, delay the date of the sale so that you meet the 12-month holding period required to get the lower capital gains rate.

The limit for deducting capital losses is \$3,000 net loss per year (“net” means all your gains minus all your losses). Anything over \$3,000 is carried over to next year until it is used up.

If you are selling only part of an investment that you acquired over time (such as a position in a stock or a mutual fund), it might be better to sell the shares with the highest cost to minimize your gain or maximize your loss. Or it might be better to sell the shares held the longest, so your gain will be taxed at the lowest rate possible. Either way, you must instruct your broker in writing which shares to sell.

If you are selling at a profit and have a child age 14 or over, consider making a gift of the stock to the child and having him or her sell it. Your capital gains rate is 15% but the child’s is probably only 5%. If the child is under 14, this still works but not as well. Children under 14 are taxed at their parents’ rate, except on the first \$1,500 of income.

Tax Loss Selling Strategies

As mentioned above, you can deduct up to \$3,000 per year in investment losses and carry over the remainder to future years until used up. But, suppose you think the stock will make a comeback. You can sell the stock, wait 31 days (in order to avoid it being a “wash sale”) and buy it back. The sale produces a deductible loss and establishes a new purchase, so that any gain from then on will get favorable capital gains treatment if held for over a year. The risk is that the stock may go higher during the 31-day period that you don’t own it.

Another approach, if you are truly convinced the stock is at rock bottom, is to buy the replacement stock and wait 31 days before selling the old one. If the stock happens to go up during that period, the gain is doubled, and, if it stays the same, you can sell the older stock and claim the loss. The risk obviously is that a further decline in value could be painful.

Also, you can sell the stock and replace it with one that is not identical but that moves in tandem with your old stock. You get the loss but still have an investment in that sector.

Timing Your Mutual Fund Sales and Purchases

Mutual fund companies are required to distribute dividends and capital gains at least once a year. Most of them do so in early December. If you own appreciated mutual fund shares held over 12 months and are considering selling, think about selling before the upcoming distribution. That way your entire gain will qualify for the 15% rate, instead of getting any non-qualifying dividend income or short term capital gains that may be part of the distribution.

On the other hand, if you are purchasing a fund and make your purchase after the ex-dividend date, you will avoid paying tax on the distribution.

Of course, these issues do not affect shares held in tax-exempt or tax-deferred accounts like Roth IRAs, regular IRAs, and qualified retirement plans.

Worthless Securities

A loss on a worthless investment is deductible only when it becomes completely worthless. Even if a company filed for bankruptcy, its stock may not yet be worthless. If you still own the stock and it has any market value at all, you cannot claim the loss. To avoid the issue of determining when a security actually becomes worthless, it may be easier to just sell it or try to sell it and get confirmation from a broker.

Education Savings Accounts (ESA)

You may contribute up to \$2,000 annually. If you have several children (or grandchildren), you can contribute up to \$2,000 to individual accounts set up to benefit each. The contributions are not deductible but the earnings in the account are allowed to build up tax-free as long as they are used to pay for the beneficiary's education related expenses.

Unlike 529 plans, you do not have to wait for college to use the funds. Eligible items include books and supplies; computers, peripheral equipment, and educational software, room and board, school uniforms, transportation, academic tutoring, and even Internet access charges. In the case of computers and related equipment, it's okay if other family members use them as long as the ESA beneficiary also uses them during any year he or she is in school.

You have until April 15th to contribute for the prior year.

Educational Savings Accounts are not permitted if the AGI of the person contributing is greater than \$220,000 for married filing jointly, and \$110,000 for all others. But you can make a gift to someone else and have him or her make the contribution. There is a \$2,000 per year limit per beneficiary.

Qualified Tuition Plans (Section 529 Plans)

Regardless of your income, you can contribute to a 529 Plan and have the earnings build up tax-free. If you contribute to the NYS plan you, you can get a deduction on your NYS tax return of up to \$5,000 (\$10,000 on a joint return) – this equates to a tax savings of about \$350 (\$700 joint). To have your contribution count for 2003, you must make it by December 31st. For more information, give us a call or go to www.nysaves.org for the NYS plan. The new NYS plan now offers more investment options.

Every state has a 529 plan and most plans now welcome out-of-state investors and will cover expenses from any accredited college in the U.S. So, you can choose the program you like best.

Also, you can have more than one account for the same beneficiary and make transfers from one plan to another or even from one family member to another. Each state plan has its own operating rules and investment results, so it pays to shop around.

Bigger Depreciation Deductions for Business Equipment

Last year's tax legislation introduced a new first-year bonus depreciation deduction equal to 30% of the cost of new (but not used) assets with a normal depreciation recovery period of 20 years or less. This year's tax law increased it to 50% for qualifying assets acquired after May 5, 2003 and before 2005.

In addition, the old rule that allows an immediate write-off (section 179 deduction) of up to \$25,000 of assets has been increased. You can now deduct up to \$100,000 for tax years beginning in 2003, 2004 and 2005.

Estate Tax Changes May Affect Your Will

Although this section does not relate to year-end tax planning, it is important enough to mention. In 2004, the estate tax exemption will be increased from \$1,000,000 to \$1,500,000. If you have a will that calls for the use of a credit shelter trust or bypass trust, you should check the wording of the will and see how the trust would actually work. Here is why:

Most wills simply call for the bypass trust to be funded with an amount equal to the current federal estate tax exemption without naming a specific figure. So, the trust might end up receiving much more money than you intended while your spouse ends up with less.

Conversely, if your will calls for a definite amount, say \$1,000,000, to go into the bypass trust, you may not be taking full advantage of the higher exemption amount.

Also, check on your life insurance coverage. If you were carrying insurance in order to pay estate taxes, you may not need as much under the new law.

If you would like some help in reviewing these issues, please call us.