



CLIENT TALK

A Service of: **RONALD J. CAPPUCCIO, J.D., LL.M. (TAX)**

Visit us on the web at <http://www.taxesq.com>

DECEMBER, 2002

YEAR-END TAX PLANNING-2002

The 2002 tax year is coming to an end, and it's time to think about actions you should take by the end of the year to minimize your taxes.

Accelerate Expenses & Defer Income

Even though tax rates are not changing next year, the amount of income subject to the lower rates is increasing, due to inflation. Thus, there is an incentive to postpone the recognition of income and to accelerate expenses into 2002. Make your January mortgage payment in December, pay any state taxes due by the end of the year, and prepay deductible expenses in December rather than postponing them until 2003. Self-employed individuals should consider postponing the collection of accounts receivable to next year, while employees may want to defer any bonuses. Sales of assets with built-in gains should also be postponed until next year (unless needed to offset losses that would otherwise be non-deductible), while assets that will generate losses should be sold this year.

Stock Market Losses

As the end of the year quickly approaches, you may be able to use your losses in the stock market to reduce your tax burden. While capital losses are first offset against realized capital gains, any excess losses can be deducted against ordinary income up to \$3,000 (\$1,500 if married filing separately). Losses in excess of this limit can be carried forward to later years to reduce capital gains or ordinary income until the balance of these losses is used up. Capital gains and losses on the sale or trade of investments are classified as either short-term – if the property has been held for one year or less – or long-term. Though these two categories of capital gains and losses are subject to different rates in the event of a net gain, a net capital loss resulting from either category is directly deductible from ordinary income up to the annual limit. This provision can work to your advantage, yielding

greater relief for losses than if the long-term capital gains tax rate is used, because capital gains rates are generally lower than the rates on ordinary income. Unfortunately, “paper losses” are not deductible.

Bonus Depreciation

In March, a new law was enacted allowing a special 30 percent first-year depreciation allowance for certain trade or business property acquired after September 10, 2001. The deduction is not prorated. If you placed property in service after September 10 of last year and did not claim the additional depreciation allowance on your 2001 tax return, you may claim the deduction retroactively. Nevertheless, this must be done by April 15, 2003. Also, if you are thinking of acquiring trade or business property in early 2003, you may want to consider accelerating the purchase into 2002 in order to take advantage of the bonus depreciation provision in 2002 rather than 2003. Note, many states, including New Jersey, do not recognize this bonus depreciation.

Child and Dependent Care Credit

If you incurred child or dependent care expenses in 2002, you are eligible for a credit. However, if your employer has a flexible spending arrangement for child and dependent care and you participate in that program, the amount excluded from gross income under the program reduces the amount available for the credit and could even reduce your credit to zero. Generally, it is more advantageous to pay your child and dependent care expenses with funds from a flexible spending arrangement and forgo the credit. However, the expenses eligible for the credit and the actual credit percentage are both increasing next year so this might not be the case in the future. If you will be in this



DECEMBER, 2002

situation next year, we should evaluate whether or not you are better off participating in the flexible spending arrangement.

Education Expenses

If you, your spouse, or a dependent are in school either as a student or a teacher, there are several changes in the area of education expenses which could affect you. First, you may be able to deduct up to \$3,000 of qualified higher education tuition and related expenses paid for either yourself, your spouse, or a dependent. This deduction, however, only applies to taxpayers with adjusted gross income that does not exceed \$65,000 (\$130,000 in the case of married couples filing joint returns). If you will be starting classes within the first three months of 2003, you may want to consider paying the tuition in December to avail yourself of the deduction. On the other hand, expenses eligible for the lifetime learning credit double from \$5,000 to \$10,000 for 2003 and, depending on your tax situation next year, it may be more beneficial to pay education expenses in 2003.

Second, two changes apply to the deduction for student loan interest this year: the provision limiting your deduction to interest paid during the first 60 months that payments are required has been repealed and the modified adjusted gross income phase-out amounts are increased. Thus, if you have student loan interest that was previously non-deductible under these rules, we need to reevaluate whether you may now qualify for a student loan interest deduction.

Third, you now have until as late as April 15 to make contributions to a Coverdell Education Savings Account for 2002. In 2002, individual contributions to a Coverdell Education Savings Account are deemed to have been made on the last day of the preceding year if the contribution is made on account of that preceding year and is made by the due date of the individual's return for that preceding year (not including extensions). In addition, a corporation may now contribute to a Coverdell Education Savings Account.

Lastly, elementary and secondary school teachers may deduct up to \$250 of certain classroom material expenses in arriving at AGI. The same deduction is available next year. Thus, if you have plans to spend more than \$250 on classroom materials in the upcoming months, you may

want to make some of those purchases in December in order to maximize the deduction.

Retirement Plan Limits

The amount of contributions or benefits that can be provided for you as a participant under a qualified plan is limited, based on the type of plan. This year, the amounts of contributions and benefits that can be provided for you under both defined contribution and defined benefit plans are increased to the lesser of 100 percent of compensation or \$40,000. The limitation on the maximum annual benefit payable on retirement under a defined benefit plan is generally the lesser of 100 percent of average compensation, or \$160,000. If you are an owner of a closely held business, and the company has not taken advantage of the increased contribution limits, there is still time to make additional contributions.

Retirement Plan Rollovers

There are now more options available for rolling over a qualified plan distribution. Beginning in 2002, you can roll qualifying distributions from a qualified plan into: (1) an IRA; (2) another qualified plan that accepts rollovers; (3) a Section 403(b) annuity that accepts rollovers; or (4) a Section 457 deferred compensation plan maintained by a government or governmental entity that accepts rollovers. If you are expecting a distribution from a qualified plan, we should meet to discuss what the best option for you would be.

Changing Retirement Distribution Amounts

If you have already begun receiving fixed payments from your IRA or retirement plan based on the value of your account at the time you started receiving payments, you may now switch -- without penalty -- to a method of determining the amount of your payment based on the value of your account as it changes from year to year. This change is effective for distributions beginning in 2002 and for any series of payments beginning on or after January 1, 2003. Thus, if there is an unexpected drop in the value of your retirement savings, your required minimum distributions are reduced, which will help you preserve your retirement savings longer. We should discuss as soon as possible whether this option would benefit you.



DECEMBER, 2002

IRA Deduction Expanded

The amount you can contribute (and may be able to deduct) to an IRA has increased. You and your spouse, if filing jointly, may be able to deduct up to \$3,000 (\$3,500 if you are age 50 or over by the end of 2002) on your 2002 tax return. If you were covered by a retirement plan, you may still be able to take an IRA deduction if your modified adjusted gross income is less than \$44,000 (\$64,000 if married filing jointly or qualifying widow(er)). You have until April 15 to contribute to an IRA.

Credit for Retirement Savings

New for 2002, you may be eligible for a credit of up to \$1,000 for qualified retirement savings contributions if your adjusted gross income is \$25,000 (\$37,500 if head of household, \$50,000 if married filing jointly) or less. If you are eligible for this credit and have not made a retirement savings contribution, you should contact me to discuss what can be done.

Earned Income Credit

Because the earned income credit has been expanded and simplified for 2002, more people qualify for the credit. You may be able to take the credit if a child lived with you and you earned less than \$33,178 (\$34,178 if married filing jointly) or a child did not live with you and you earned less than \$11,060 (\$12,060 if married filing jointly). In addition, non-taxable earned income and modified adjusted gross income are no longer taken into account. Instead, taxable earned income and adjusted gross income are used to determine if you can take the credit and the amount of the credit. Finally, the alternative minimum tax no longer reduces the amount of the credit.

Adoption Expenses

Expenses eligible for the adoption credit have increased this year to \$10,000 per child. Note, the credit is phased out if your adjusted gross income exceeds \$150,000.

Lifetime Gift Exclusion

You can now give away more of your estate, thus avoiding estate taxes on that portion gifted away. The lifetime gift exclusion has increased to \$1,000,000 for both 2002 and 2003 with additional increases scheduled after that. If you are in this situation and do not have a gift plan in place, we should meet to consider your options.

Finally, for next year, you should be aware of the following changes:

* The standard mileage rates decrease to 36 cents per mile for all business miles driven and to 12 cents a mile for the use of your care for moving and medical reasons.

* The estimated tax safe harbor for higher income individuals (other than farmers and fishermen) has been modified for 2003 estimated tax payments. If your 2002 adjusted gross income is more than \$150,000 (\$75,000 if you are married filing a separate return for 2003), you must have deposited the smaller of 90 percent of your expected tax for 2003 or 110 percent of the tax shown on your 2002 return to avoid an estimated tax penalty.

* The child and dependent care credit increases from 30 percent to 35 percent of qualifying expenses, the maximum adjusted gross income that qualifies for the highest credit rate increases to \$15,000, and the limit on the amount of qualifying expenses increases to \$3,000 for one qualifying individual and \$6,000 for two or more qualifying individuals.

Estate Planning

Now is the time to consider reviewing your estate plan. Changes in the Estate and Gift Tax at both the Federal and State level probably will impact you. Make a commitment to yourself and your family to review your estate plan today!



RONALD J. CAPPuccio, J.D., LL.M.(TAX)
COUNSELLOR AT LAW
1800 CHAPEL AVENUE WEST, SUITE 128
CHERRY HILL, NEW JERSEY 08002
[HTTP://WWW.TAXESQ.COM](http://www.taxesq.com)

Important Newsletter for Our Clients!

