LOOPHOLES

News You Can Use for Current Tax Planning

IRS Update — Rundown on Recent IRS Activity

Several changes have been handed down by the IRS this year. Here's a quick summary:

Flex accounts can pay for over-the-counter drugs. The IRS will now permit taxpayers with flexible spending accounts and other employer health reimbursement plans to use those funds to buy over-the-counter drugs such as aspirin, flu medications, allergy pills, and cold medicines. Over-the-counter drugs still will not qualify as itemized medical deductions.

Tax numbers adjusted for 2004. Adjustments are made to many tax numbers each year, the result of tax law change and inflation. Among the changes that you need to factor into your tax planning for this year are the following:

- The top estate tax rate drops to 48%, and the amount exempt from tax increases to $1.5 million.
- The deduction for qualified higher education expenses increases to $4,000 this year, up from last year's $3,000 maximum. For those with incomes too high to qualify for this deduction, a new $2,000 deduction for college expenses is available if income doesn't exceed $80,000 ($160,000 for joint filers).
- The kiddie tax threshold increases from last year's $1,500 threshold to $1,600 for 2004.
- The business equipment expensing limit increases to $102,000.
- Retirement plan contribution limits increase to $13,000 for 401(k)s and to $9,000 for SIMPLEs. With catch-up contributions, those 55 and older can contribute $16,000 to a 40l(k) and $10,500 to a SIMPLE.

For details or for assistance with any of your tax concerns, please contact our office.

There's New Help to Cover Health Care Costs

There's new help from Washington to cover the costs of health care: Health Savings Accounts (HSAs), which were included in the Medicare Act of 2003. HSAs are similar to IRAs, but they also have some unique features. You can make a tax-deductible contribution for 2004 of up to $2,600 to an individual HSA or $5,150 to a family HSA. If you're 55 or older, your annual contribution can be $500 higher. If your employer makes the contribution as part of a cafeteria benefits plan, it isn't taxable to you. Earnings on investments made with your contributions won't be taxed currently, and withdrawals are also tax-free if they are used for a broad range of medical expenses.

Of course, there are restrictions. To be eligible for an HSA, you must be covered by a health plan with a deductible of at least $1,000 annually for an individual or $2,000 annually for a family. These "high deductible" health plans can save you money, since they should have lower premiums. You must be under 65, and therefore not eligible for Medicare, when opening an HSA. Your contribution can't be greater than the deductible on your insurance, nor can you be covered by another plan with a lower deductible for the same benefits. If you withdraw HSA funds for nonhealth expenses, you'll pay taxes, plus be subject to a penalty if you do it before age 65. Some other conditions also apply.

You should consider an HSA if you're interested in building a nest egg to cover future health care costs, as an alternative to a flexible health care spending account, or if you're willing to exchange lower premiums for higher deductibles. To discuss the potential benefits in more detail, give us a call.

Listen to *Loopholes* every Wednesday, 6:00-7:00 p.m. on KPSI Newstalk 920AM

Howard Gordon, CPA

Standard Mileage Rate Increase for 2004

The 2004 optional standard mileage allowance rate for computing the deductible costs of operating a car for business purposes will increase from 36 cents per mile in 2003, to 37.5 cents per mile in 2004. In other good news, the IRS will now permit businesses to use the standard mileage rate if no more than four vehicles are used. Previously, a business had to keep track of actual expenses, such as gas, repairs, and insurance, if more than one vehicle was used.

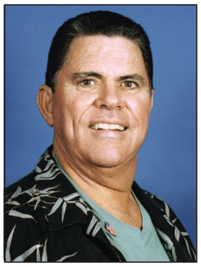
The rate for medical or moving expense purposes will increase from 12 cents per mile to 14 cents per mile in 2004.

The new rates apply to costs paid or incurred on or after January 1, 2004.

Make Tax-Free Gifts

The IRS allows you to give away up to $11,000 each year to as many people as you want, without triggering gift tax. If you and your spouse "split" your gifts, you can double this $11,000 annual gift-tax exclusion and give $22,000 per recipient.

If you're thinking of sharing your wealth, here are some important gift-giving considerations.


Bill Kelly, PFP

All gifts during the year, including birthday and holiday presents, count toward the $11,000 (or $22,000) annual gift tax exclusion. For example, say you give a $500 birthday present to your grandchild. You may give another $10,500 to that grandchild during the year without triggering the need for a gift tax return.

A gift made by check isn't complete until the recipient actually deposits or cashes the check. Plan accordingly when making year-end gifts, especially if you want such gifts to be counted toward this year's gift-tax exclusion.

For a gift to be valid, you must part with ownership. Pay special attention to gifts of stock in the family business or gifts of your personal residence.

Carefully consider the type of asset before you give it away. Property that has substantially appreciated in value may not be a good candidate for giving. Keeping it may allow for a step-up in basis in your estate. If you own stock or other property that has declined in value since you acquired it, you may be better off selling the property and giving away the proceeds. Giving away a life insurance policy can be an excellent strategy, but it's subject to some tricky rules.

Of course, you should never make a substantial gift unless you can afford to part with the property. And any gift-giving program should be part of an overall estate plan. Call us if you'd like assistance with your gift and estate planning.

Do You Need A Speaker?

MMGC's tax and business consulting team is available to give customized presentations to your business, civic or social group at no charge. **David Suss** has developed a short musical comedy presentation called, **"The Funny Side of the IRS"** which has proved very popular. Our team is available to speak on a variety of additional topics including:

- How Much is My Business Worth?
- Becoming a Better Leader
- Strategic Planning
- Tax Tips
- Bulletproofing Your Tax Return
- Understanding Mutual Funds
- Fiscal Fitness for Women
- Estate Planning

Contact Kim McNulty at 320-6642, ext. 8560 to schedule a speaker.

Real Estate Investing Calls for Tax Planning

If you invested in real estate recently, now may be a good time to review real estate tax rules. A little planning may help you take advantage of some tax breaks.

Tax law is a bit onerous if you invest in real estate for rental income or to realize capital gains from the sale of the property. The IRS differentiates between real estate professionals and those who are passive investors. Most people are generally considered to be passive investors unless they spend more than 750 hours in real estate activities and spend most of their working hours in the real estate profession.

The classification of your real estate activities as a professional or passive investor will have a major impact on your taxes. The biggest drawback is on the restrictions on the amount of losses that you can deduct as a passive investor. Passive losses can only be offset against income from other passive activities, such as income from certain partnership activities and rental income. The losses cannot be deducted against income from wages or investment income from dividends and interest. Therefore, if you have passive real estate losses, you may not be able to use those losses to reduce your taxable income in the current year. However, the IRS does allow you to deduct those losses when you sell the property, or you may carry forward the losses to future years to offset passive income.

Steve Erickson, CPA

Don't forget to take depreciation deductions. Residential buildings are depreciated over 27.5 years. Commercial buildings are depreciated over 39 years. Land is not depreciable. Therefore, make sure that the cost of the property has a reasonable allocation between the building, improvements, and land. Remember, also, if you sell real property that you owned for more than a year, some of the gain is taxed at lower capital gains rates.

For some investors, trading real estate in a "like-kind exchange" may be a great way to defer taxes. For more information on this strategy and other tax-wise real estate planning techniques, please contact our office.