Tax Tips

Summer 2003

Individual

Donating Noncash Items to Charity

Are you getting the full tax benefit on the gifts you make?

You have done your spring cleaning and now you have boxes of household items and outgrown clothing. Should you toss them, have a garage sale, or hold on to them for a while longer?

If you opt for a garage sale, you have to devote time to making everything presentable, marking prices, setting up tables, advertising, and attending to the sale. The benefit is instant money for all your hard work, but generally at far less than what the work and items are really worth.

A better option might be to donate that property to a qualified charity such as Goodwill, the Salvation Army, or your local church. If you are able to itemize, you can deduct the fair market value (FMV) of the property you donate to charity. Some of the most common mistakes that people make when donating property are:

1) Failure to document what was actually donated to the charity. Say you donated six men's shirts, two pairs of children's shorts, three blouses, and five pairs of men's pants, chances are you just put everything in a bag and told your preparer that you donated a bag full of clothing, but you have no documentation. Keep a good list of the items you donate.

2) Under valuing the property that was given to the charity. This is always a subjective area but the law states the deduction is equal to the FMV of the property given. What do you use as the FMV? If you give used clothing to Goodwill, for example, the FMV would be the price that typical buyers actually pay Goodwill for clothing of this age, condition, style, and use. Along with a detailed list of the items you donate, establish a value for each item. Local thrift stores often have a list of items with suggested values.

3) Failure to obtain documentation that the charitable organization received the property. Charitable organizations will provide you with a receipt acknowledging your contribution. Sometimes you need to ask.

If you can establish these three areas, you are in complete compliance with the law and are allowed to deduct the value of all property you donate to a charity.

Preserve Your IRA Investment

Avoid losing your savings to the annual fee

Recent tax law changes allow you to roll over, tax-free, any traditional IRA account into a qualified retirement plan – such as a §401(k) or §403(b) – allowing you to consolidate your various IRA accounts with your retirement plan. This will save you from paying an annual fee for your IRA and from getting mailed an assortment of account statements for several IRA accounts.

This preserves your IRA assets because most IRA trustees (bank, brokerage house, etc.) charge an annual fee just for maintaining an IRA account with a balance of $0 to $50. Generally, the IRA trustee will send you a notice to pay the fee and if you don't, the money is deducted from your IRA account. This can be very expensive if the account has a small balance. If an account balance is $1,000, then a $50 fee would be equal to losing 5% of your account. Unfortunately that $50 is gone forever.

You can avoid losing your IRA to annual fees by transferring the IRA account to your retirement plan. First, however, contact your plan administrator to get the necessary paperwork and to make sure your retirement plan accepts IRA transfers (not all plans are required to accept IRA rollovers).

Take Advantage of Tax Savings in a Down Stock Market

Know when you have a deductible loss

Despite a repressed stock market in the past few years, you don't necessarily have a deductible loss. As long as you hold an investment, you only have a "paper" loss. It is when you sell the investment that you have a transaction to report on your tax return.

The tax law allows you to offset your capital gains by your capital losses. You can sell both investments that are at a gain and at a loss, allowing you to avoid or minimize taxable gain by offsetting the two.

However, an investment sold at a loss is not gone forever. If you believe it was a good long-term investment, you can wait 31 days and buy it back. This strategy works very well if the price of the investment either stays the same or goes down further. For example, you sell 100 shares of XYZ Company, which you purchased for $3,000, and receive $2,500 in cash proceeds from the sale. You can use the $500 loss to offset capital gains or other income. Let's assume you want to buy back XYZ stock because it is a good long-term In vestment. Wait 31 days so you won't lose the tax advantage of the $500 loss because of the wash sale rules. If the price of 100 shares of XYZ is $2,500 or less, then you can use the proceeds from the first sale to buy the stock back without having to provide any additional money.

What if you are over age 59½ and have IRAs? Are there any potential tax savings because the stock market is down? This is an excellent time to take distributions (either voluntary or required) of the actual investment from your IRA, instead of cash. If you are over age 59½, you escape the additional 10% premature distribution penalty. Many IRA accounts will allow you to take either cash or the actual investment, such as stock, instead of cash. If there are investments within your IRA account that you want to hold long-term, but the value is currently down, you may want to consider having that investment distributed to you. Be aware that this is a taxable event and the fair market value of the investment must be reported on your tax return. However, any appreciation earned after the distribution will not be taxable until you sell the investment. This provides several advantages: 1) if you sell the investment, it will be taxed at the lower capital gains rate, which may be less than the rate for your IRA distribution; 2) it reduces your IRA account so your required minimum distributions may be smaller in future years; and 3) you can gift that investment to a person or charity at a later date.

As always, it is recommended that you consult your investment and tax advisor prior to taking any actions.

Save Tax Dollars by Saving for Retirement

New credit offers tax savings to you

The IRS is allowing a tax credit for certain taxpayers who save for retirement. The credit was first allowed on 2002 income tax returns and will be allowed again in 2003. You may be eligible to take a tax credit of up to $1,000 ($2,000 if married filing jointly) for making eligible contributions to an employer-sponsored retirement plan or to your IRA.

You cannot claim this credit if any of the following apply:

- Your adjusted gross income in 2003 is more than $25,000 ($37,500 if head of household, $50,000 if married filing jointly).
- You were born after January 1, 1985.
- You are claimed as a dependent on another person's tax return in 2003.
- You were a full-time student in 2003.

Job Hunting Expenses

Are your costs deductible?

It's never easy finding a new job. Whether you have been downsized, pushed out, or just needed a change of employer, your expenses for looking for the ideal job in your present career field just may be deductible.

The first thing to remember is that you must be able to itemize your deductions before you are allowed any deduction at all. Even then, your job-hunting expenses, along with other miscellaneous deductions, must exceed 2% of your adjusted gross income. This fact alone prevents many people from saving documentation that substantiates these types of expenses. Don't let this stop you from saving your receipts anyway. You just may be surprised at how fast they add up. Even if your job search is unsuccessful, your expenses may be deductible.

The second thing to remember is that not all job-hunting expenses are allowed. For example, expenses for looking for a new job in a different occupation than the one you held previously are not deductible, nor are expenses for looking for your first job in any occupation. If there was a substantial break between the ending of your former job and the beginning of your quest for a new job, the expenses are also disallowed.

Here is a quick list of what is deductible:

- Employment agency fees.
- Costs for a résumé, including amounts you spend for typing, printing, and mailing.
- Travel expenses you pay if the trip is primarily to look for a job. Travel expenses include costs for transportation, meals, and lodging.

As with any expense, if you are reimbursed for any of your costs, you are not entitled to a deduction.

Are You Planning a Summer Wedding?

Don't be surprised at tax time

You will get all kinds of advice when you plan a wedding. Did you ever think this would include tax advice? Have you heard about the "marriage penalty?" Surprisingly, income taxes are often overlooked when a couple decides to marry.

We have all heard the old adage, "Two can live as cheaply as one," but that saying won't necessarily hold true when it comes to your taxes. If both of you have income, and your income is substantial, you may pay more tax on a joint return than if you were still single. This is because the standard deduction for married taxpayers is not twice as large as the standard deduction for singles. Also, the tax rates jump into the higher brackets for married couples more quickly than for singles. For this reason, it is sometimes called a marriage penalty.

Not every couple falls prey to the marriage penalty and even if you do now, many of the proposed tax changes are designed to ease the tax burden on married couples. The closer your incomes are to each other, the larger the marriage penalty. If you are planning a wedding close to the end of the year, compare your joint tax liability to that of two single taxpayers. If it looks like you will be paying more taxes than you expected, there is still time to adjust your withholding before the year is over. You can change your withholding by filing a new Form W-4 with your employer.

One more thing to keep in mind – if you are going to change your last name, notify the social security administration office. This will prevent any mismatches and processing delays when you file your first joint return.

Teachers Get a Tax Break

New deduction allowed for out-of-pocket costs

If you are an elementary or secondary school teacher, aide, counselor, principal, or other eligible educator who worked at least 900 hours in a school during 2003, you may deduct up to $250 for classroom supplies that you purchased during the year. You may claim the deduction even if you do not itemize deductions. Qualifying costs for the deduction include books, supplies, equipment, computer equipment (including related software and services), and other materials used in the classroom. Currently, there is no law that allows teachers who home-school their children to take this deduction for supplies they purchase for the classroom.

New Rules for Home Sales

Do you have to pay tax on your gain?

In December 2002, the IRS released new rules for the sale of a home. The new rules clarify the partial exclusion of gain rules when you fail to meet the two out of five years ownership and use tests. The general rule allows you to exclude from income, up to $250,000 of the gain ($500,000 if you file a joint return), if you own and occupy your home for at least two years out of five years prior to the date of sale. In some situations, unforeseen circumstances arise making it necessary for you to sell your home and move before these tests are met. You may be eligible for a reduced exclusion if you sold your home before the end of the two-year period if any of the following apply:

- Change in the place of employment forces a move.
- Poor health.
- Involuntary conversion of the residence.
- Death.
- Natural or man-made disaster, or act of war or terrorism.
- Change in employment or self-employment results in an inability to pay housing costs.
- Divorce or legal separation.
- Multiple births resulting from the same pregnancy.