TAX UPDATE BULLETIN

Perkins & Associates, P.S.

Certified Public Accountants

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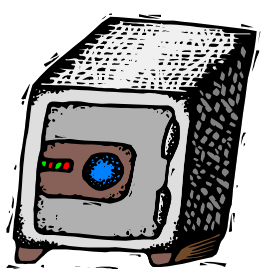
Pension and IRA changes

Regular IRA-You can contribute $3,000 in 2002, with an extra $500 contribution allowed if you are 50 or older. The plan must be established and funded by April 15th of 2003 for the 2002 tax year. If you or your spouse participates in an employer sponsored retirement plan your deduction is limited as shown in the next paragraph.

If you are single and participate in an employer sponsored plan your deduction starts to phase out at $34,000 of AGI and is eliminated at $44,000 or more of AGI. If you are married and participate in an employer sponsored plan your deduction starts to phase out at $54,000 of AGI and is eliminated at $64,000 or more of AGI. If you are married and your spouse participates in an employer sponsored plan your deduction starts to phase out at $150,000 and is eliminated at $160,000 of AGI.



Roth IRA-You can contribute $3,000 in 2002, with an extra $500 contribution allowed if you are 50 or older. The plan must be established and funded by April 15th of 2003 for the 2002 tax year. Allowable contribution limited by income starting at $150,000 if MFJ, $95,000 if single. The income limitation applies whether you participate in an employer pension or not (unlike the regular IRA discussed above).

SEP IRA-You can contribute up to 25% of compensation in 2002. For a self employed person this is actually 20%. The plan must be established and funded by the tax filing date, including extensions. For the 2002 tax year this means any time until September 15, 2003 if you file a form 1120 or 1120S for a corporation. You have until October 15, 2003 if you file a form 1040 or 1065. No extra 50 or older catch-up contribution allowed.

Profit Sharing Plans (Keogh)-You can contribute 100% of compensation up to $40,000. The plan must be established by December 31, 2002 for the 2002 tax year. Contributions can be made up to the tax filing date of the business, including extensions. The dates are the same as for the SEP IRA described above. An extra $1,000 contribution is allowed if you are 50 or older.

Single person 401K plan-This is a new plan created by recent changes in the tax code. It allows a higher contribution than some of the other plans. You should get some advice to compare this to the profit sharing plan to see which would work the best for you if you want to maximize your pension contribution.

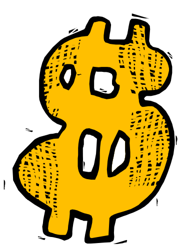
Business Depreciation

Section 179-The deduction limit is $24,000 in 2002 and will be $25,000 in 2003.

Additional 30% depreciation in the 1st year-As part of the economic stimulus package passed after 9/11 an additional 30% depreciation deduction is allowed in the first year equipment is placed in service. This applies to equipment (other than buildings) placed in service between September 11th, 2001 and September 11th, 2004. The 30% depreciation is taken first and then the normal 1st year depreciation percentage is taken on the remaining adjusted basis. The remaining years will have a somewhat reduced amount of depreciation as a result since the total depreciation over the life of the equipment doesn't change. If you don't want to claim this extra depreciation in the first year you must file an election to opt out.

NOL carry backs

In 2001 and later years if you have a net operating loss (NOL) you can carry it back five years, two years, or skip the carry back and just carry the NOL forward. The default is to carry the loss back five years. If you want to carry back two years or just carry forward you have to file an election to chose that option and opt out of the five year carry back.



Will I be audited?

This is a frequently asked question. While audits are not that common these days they do happen. Here are a few things to avoid.

Large Schedule C losses year after year. This is a particularly problem if you or your spouse also has wage jobs with good salaries as the activity may appear to be a hobby.

Large miscellaneous 2% itemized deductions on your Schedule A. Sizable employee expenses on that schedule will draw the IRS's interest. If you own an S or C corporation take your expenses in the corporation rather than as an employee. You also avoid losing part of the deduction because of the 2% of income reduction.

Showing total business revenue which is less than the sum of any 1099s which you have received. The IRS will add up your business 1099's and if your return shows less revenue than the 1099 totals they will follow up with an inquiry. Sometimes there are legitimate timing issues when you don't receive the cash until the following year.

Donating your old auto to charity

The IRS recently issued some additional guidance on this issue. In general you can donate your old car and deduct the "fair market value" of the vehicle as a charitable deduction. It is up to you to substantiate what the fair market value is. You are allowed to use a Nada or Blue book to determine the retail value of the car as long the pricing book lists an auto of the same make, model, year, geographic area of sale, and condition as the one you are donating. This works well if the car is in good condition. If the car is in poor shape you probably can't use a guide book to determine fair value as they don't provide pricing on autos in poor condition. An alternative is to get a written price quote from a used car lot.

(donating your auto to charity continued...)

To deduct a charitable contribution over $250 you need to receive a written acknowledgement from the charity at the time of the donation that shows the following: a) a description of the vehicle or item contributed (the charity won't estimate a value for you). b) Whether the charity provided you goods or services in return. c) The value of any goods or services they gave you in return.

Educational expenses

In 2003 you will be allowed to deduct up to $3,000 in qualified tuition and related expenses on the front of your 1040 as long as your income is not more than $65,000 if single or $130,000 for a joint return. If you claim this deduction for yourself or a dependent you can't take a Hope or Lifetime credit for that person in the same year.

The Lifetime Learning Credit for 2003 will go up to 20% of $10,000 in expenses for an allowed deduction of up to $2,000 in a year. The Hope Credit stays at a maximum of $1,500 a year for the first two years of college. The Hope and Lifetime Learning Credits phase out at incomes of $41,000 to $51,000 if single or $83,000 to $103,000 if married filing jointly.

Student loan interest of up to $2,500 is deductible but the deduction phases out between $50,000 and $65,000 of income if single and $100,000 to $130,000 if married filing jointly.

Self employment health insurance

In 2002 70% of any health insurance you pay for as a self employed person is deductible on the front of your 1040. This includes payments for your spouse and dependents. It also includes payments for long term care insurance. The percentage will go up to 100% in 2003.

Estimated tax payments

As a self employed person figuring out your estimated tax payments can be a real headache. In general the requirement is that you pay in 2003 the lesser of 100% of 2002 tax owed or 90% of the 2003 tax due. If your income was over $150,000 in 2002 the percentage is 110% of the 2002 tax or 90% of the 2003 tax due. The fact that the government sent you tax vouchers does not automatically mean that you have to make payments. If you applied an overpayment from last year and it meets your taxes for this year you don't have to make any more payments. If you or your spouse has a job with wages you can also increase your withholding to make the required payments. Our policy is to have a client pay as little as possible without incurring a penalty.
If you don't make your estimated payments as required the penalty is an interest charge of 6% on the unpaid amount.

Non-filing and underpayment of tax

If you owe money and don't file a return you are subject to a number of penalties. There is a penalty for failure to file and another for failure to pay the tax due. Together these can add up to a maximum of 25% of the amount of tax due. In addition, the penalty for failure to file is added to the amount of tax due and that balance currently accrues an interest charge of 6% compounded daily. The penalty for underpayment for estimated taxes discussed in the previous paragraph is separate from these penalties and is also required to be paid if due.