2004 YEAR-END TAX PLANNING ALERT

Year-end tax planning can be especially rewarding this year. 2004 has been a major year for tax developments. The *American Jobs Creation Act of 2004* and the *Working Families Tax Relief Act of 2004* have combined to result in more new tax law being enacted this year than at any time since 1986. The IRS, too, has had a banner year in issuing a flood of tax rules and guidance. But, rather than being overwhelmed by these record-breaking events, we see them as great opportunities to lower your overall tax payments and to help you avoid new tax traps. Year-end tax planning is the key to start to unlock many of those savings immediately.

Three reasons make year-end planning important this year:

1. ***Last-minute opportunities:*** Legislative changes in the tax law make certain tax breaks available only through December 31, 2004 - act now, or never again;

2. ***Limited time to prepare:*** Legislative changes create certain opportunities or pitfalls which start on January 1, 2005 - preparation can give you a head-start on both fronts;

3. ***New application of traditional considerations:*** You should not lose focus of traditional year-end tax planning techniques - especially as they apply to differences in your individual tax profile since last year.

Unlike any other time of the year, late Fall finally provides you with a fairly accurate view of how your income and deductions for the year will turn out. Armed with that snapshot, we usually can craft certain tax-planning steps to alter the results more in your favor. With legislation as an added variable this year, year-end tax planning offers many more opportunities to save overall taxes in this way.

- **Last minute opportunities**

  Legislation has created a long list of "must-do" items to take advantage of tax breaks which either run out at the end of the year or are limited by annual amounts which start again in 2005:

  [*Note:* The following list is not comprehensive and specific items affecting your particular tax situation may not have been included.]

  - ***50 percent bonus depreciation***

    Bonus depreciation can be of tremendous value to a business. A full additional 50 percent of the cost of business equipment and other property, in addition to regular depreciation, may be written off in the year of purchase. Bonus depreciation ends, however, on December 31, 2004, and it isn't being renewed. If your business is planning a purchase, doing it in 2004 rather than in early 2005 may save you thousands of tax dollars.

- ***Vehicle donations***

  Starting in 2005, your deduction for a vehicle contributed to charity for which you are claiming more than a $500 deduction will be limited to the price the charity gets for selling it - that's usually a deeply-discounted wholesale price. If you're thinking of donating a used car or truck soon, do it by the end of this year if possible, when you still can deduct its full fair market value.

- ***State sales taxes***

  Up until 1987, taxpayers could take itemized deductions for both their state and local income taxes and their state and local sales taxes. The 1986 Tax Reform Act did away with the deduction for sales taxes. The new law brings it back, but only as an option to be taken instead of state and local income taxes. Taxpayers in states with low- or no-income taxes will benefit. Since this option is effective retroactively to the start of 2004, many taxpayers are now scrambling to find sales receipts, especially if they purchased several "big-ticket" items earlier this year. The IRS has not yet promised when it will be publishing average sales tax tables to be used in lieu of producing receipts for day-to-day purchases. For those taxpayers affected, timing big-ticket purchases and even alternating between taking the sales tax and the state income tax deduction each year may make sense.

- ***Teachers' deduction***

  Congress has reinstated the $250 per year "teachers" deduction for out-of-pocket classroom expenses, retroactively back to January 1, 2004.

- ***Business credits and deductions***

  Over a dozen business tax credits and deductions which expired earlier in 2004 or at the end of 2003 have been extended through 2005, including the work opportunity tax credit; welfare-to-work tax credit; the research credit; charitable contributions of computer technology and equipment used for educational purposes; expensing of environmental remediation costs; credit for electricity produced from certain renewable resources; suspension of the 100-percent-of-net-income limitation of percentage depletion; credit for qualified electric vehicles; deduction for qualified clean-fuel vehicle property; and for contributions to Archer medical savings accounts.

- **Limited time to prepare**

  Many of the provisions in the *American Jobs Creation Act* start on January 1ST. Among them, two new tax opportunities and one giant pitfall - stand out as requiring preparation in 2004 to maximize their benefits in 2005:

  - ***Manufacturers' deduction***

    Effective January 1, 2005, a significant new deduction arrives for many businesses. Called the "manufacturers' deduction," it will benefit a considerable number of businesses not traditionally thought of as manufacturers. The new deduction isn't just for businesses which make things, such as auto, steel and paper manufacturers. Congress chose to define "manufacturer" very broadly. In addition to traditional manufacturers, businesses which qualify for the new deduction include construction firms, engineering and architectural firms, film and video production companies, computer software makers, agricultural processors and many service providers. The deduction starts at three percent and grows to nine percent by 2010.

If you own a business, it may qualify either in whole or in part for the new deduction. Planning to be ready to start maximizing this new tax break on January 1ST should start now. Many questions remain to be answered by the IRS, so putting your business in a position to change course quickly, depending on upcoming IRS rules and regulations, is an important step to take as soon as possible.

- ***S corporation reform***

  Many people choose to operate their businesses as S corporations because they combine the best of corporations and partnerships. S corporations are so popular they are one of the fastest growing business entities in the U.S.

  S corporations are sure to be even more popular under the new tax law. Instead of 75 shareholders, S corporations can have 100 shareholders. One family can also elect to be treated as a single shareholder. If you're thinking of starting a business, or converting your business to a different structure, the new rules make S corporations very attractive. All these changes apply to tax years beginning after December 31, 2004.

- ***Non-qualified deferred compensation***

  The new law makes important changes to the tax law as it is applied to deferred compensation. Most of these changes start immediately on January 1, 2005. Preparation, starting now, can save major problems next year. If certain operational or design failures occur in a non-qualified deferred compensation plan, the deferred amounts will be included in the affected plan participants' gross income immediately unless it is still subject to a substantial risk of forfeiture. The plan failures which a non-qualified plan must avoid include those having to do with distributions, the acceleration of benefits and the timing and nature of the election to defer compensation and other elections allowed under the plan.

■ Traditional considerations

Year's end signals your last chance to balance the timing of income and deductions for tax purposes between the current and the upcoming year to your maximum advantage. Accelerating payment of expenses to generate deductions, deferring receipt of income to defer payment of tax on it up to a full year, carefully timing capital gains to match capital losses and making last-minute contributions to tax-deferred accounts, such as retirement savings and flexible spending accounts, all play roles in a successful year-end tax strategy. So should testing your current tax status for alternative minimum tax (AMT) liability. Year-end planning can reduce exposure to this "stealth" tax which trapped over one million taxpayers last year and continues to grow. If you've had a change in circumstances during the year - such as marriage or divorce, birth of a child, a death, promotion or job loss, inheritance or property loss - year-end tax planning takes on extra importance, too.

Other traditional considerations include:

- Minimizing taxable income to reduce tax on social security benefits;
- Timing taxable gifts to take advantage of the $11,000 annual gift tax exclusion ($22,000 for couples).
- Bunching medical expenses and/or miscellaneous itemized deductions to maximize use in connection with adjusted gross income minimums;
- Deferring or accelerating year-end bonuses;
- Increasing S corp or partnership basis to enable deduction of losses;
- Paying expenses by using a credit card to accelerate deductions without the need for immediate cash.