

# taxolutions<sup>SM</sup>

## 2002 Tax Act Brings Tax-Saving Opportunities

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With the stroke of his pen last March, President Bush enacted the Job Creation and Worker Assistance Act of 2002. At the heart of the new law are provisions designed to stimulate the economy by helping businesses affected by 9/11.

### It's Bonus Time!

The 2002 tax law gives businesses a new write-off that allows them to immediately deduct 30% of the cost of qualifying assets. The remaining 70% is then depreciated or amortized according to normal tax rules. In general, qualified property includes:

- Most property having a depreciable life of 20 years or less (so, buildings won't qualify),
- Most computer software,
- Qualified leasehold improvement property, or
- Water utility property.

The property must be acquired after September 10, 2001 and before September 11, 2004. A written binding contract will be considered the acquisition date. Another major requirement is that the property must be “original use” property. If you buy used property (including buying a business), that property isn't entitled to the additional 30% depreciation. But, if you recondition or make improvements to property you own, those expenditures will qualify for the bonus depreciation.

Qualified leasehold improvement property includes improvements, made by either the lessor or lessee, to the interior of a non-residential property that has been in use for more than 3 years. The following do not qualify: enlargement of a building, elevators or escalators, structural components of common areas, or internal structural framework.

More good news... the 30% bonus depreciation applies for both regular and AMT purposes.

While the bonus depreciation is a great break at the federal level, it may complicate your state tax situation. Some states have always had their own rules for depreciation; others may be in a technical bind

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# Between A Rock And A Hard Place: Minimizing Both Estate And Income Taxes

If your estate is worth between \$1 million and \$3.5 million, estate planning has become a lot more complicated than it was before the 2001 Tax Relief Act. How so? Over the next 7 years, the amount that can pass tax-free at death to your heirs gradually increases (see the chart).

## Increases in Applicable Exclusion Amount (AEA)

2002 & 2003	\$1,000,000
2004 & 2005	\$1,500,000
2006, 2007 & 2008	\$2,000,000
2009	\$3,500,000

While these increases in the Applicable Exclusion Amount, or AEA, are good news for taxpayers, there are several things to keep in mind when planning to minimize estate taxes.

1. Although the estate tax is slated for repeal in 2010, it will be reinstated in 2011 (with a \$1 million AEA) unless Congress makes the repeal permanent.
2. Although the AEA for estate taxes increases, the amount that can be “gifted” during a lifetime without paying gift tax remains at \$1 million, even after repeal of the estate tax.
3. For deaths prior to 2010, the income tax basis of assets owned at death will be adjusted to their current fair market value. Typically, this results in significant income tax savings for the heirs when the assets are sold. In 2010, this basis “step-up” will be limited.

## What About Bob?

Let’s look at Bob, a recent widower. Bob’s estate is worth \$2 million, and he plans to leave everything to his children. His assets have appreciated substantially in value since he acquired them, and he expects that trend to continue.

If Bob were to die prior to 2006, it’s very likely his heirs would incur a significant estate tax bill (\$225,000 to \$410,000 or more), since only \$1 million or \$1.5 million would be sheltered by the AEA. Even

if he lives beyond 2006, the appreciation of his assets may overtake the increases in the AEA.

If estate taxes were the only consideration, an estate planner would typically advise Bob to make gifts to his children, at least to the extent of the annual exclusion (\$11,000/person), and possibly use a portion of his \$1 million gift tax AEA to remove future asset appreciation from his estate.

But estate taxes are not the only consideration. If Bob gives his children an asset which has appreciated in value, the income tax basis of the asset carries over to them, and they will have to pay income tax when the asset is eventually sold, assuming it doesn’t decrease in value. On the other hand, if Bob owns the asset when he dies and his children inherit it, the basis will be adjusted to fair market value at that time.

Therein lies a dilemma: a) If Bob gives away assets which would have been sheltered from estate tax by future increases in the AEA, he has “wasted” the opportunity to have the income tax basis of those assets increased upon his death; b) on the other hand, if Bob owns assets at death

worth more than the available estate tax AEA, there will be an estate tax liability.

## What To Do?

Death tends to come on its own timetable. So how can you plan around the complexity of the law? There is, unfortunately, no perfect answer to this problem, since a lot depends upon personal circumstances. But, here are a few ideas to consider:

1. Make gifts of “high basis” assets (basis close to or above current market value) first. This will minimize the loss of income tax benefits from the basis step-up at death.
2. Avoid making gifts that will reduce your potential taxable estate below the available estate tax AEA (currently \$1 million).
3. Think about using a Family Limited Partnership or LLC as a hedge against estate taxes and income taxes.

And of course, your first course of action should be to consult with us. We can help you navigate the nuances of the tax law to the benefit of both you and your heirs.



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because their tax laws may be written based on prior federal law, which doesn't include the 30% bonus depreciation. Even those states that normally follow federal depreciation rules may balk at allowing this provision because of the potential hit to their own tax coffers.

### Additional Depreciation For Business Vehicles

For business vehicles subject to the luxury auto rules, the limitation on depreciation is increased by \$4,600 in the first year (from its current \$3,060). This means that most autos will get \$7,660 depreciation in the year purchased. Because of this faster write-off, now may be the time to buy a new business car.

### Longer NOL Carryback

If your business has been limping along, you'll be glad to hear that the new law now allows you to carry back any net operating losses (NOLs) generated in 2001 or 2002 for 5 years! Previously, the NOL carryback period was 2 years.

You can elect to forego the carryback period and carry all of the loss into future years. You might want to do this if you already had losses or lower tax rates in the carryback years. Or, you can elect out of the 5-year carryback period and revert to the 2-year carryback. You can maximize your tax refund by considering these alter-

natives. Once you make an election, you cannot change your mind.

As under prior law, NOLs that cannot be carried back are carried forward and can be used to offset taxable income earned over the following 20 years.

Qualifying 2001 and 2002 NOLs will also offset AMT income at 100%, instead of the previous 90%. This applies to NOLs generated in 2001 and 2002, as well as to losses carried to 2001 and 2002.

### NYC Liberty Zone

Businesses or owners of property located in the newly designated "Liberty Zone," the area of lower Manhattan most affected by the destruction of the World Trade Center, may have their economic difficulties eased somewhat by these special tax breaks:

- The Section 179 deduction limitation (for expensing business assets) is increased by \$35,000 to \$59,000 for 2001 and 2002.
- The 30% bonus depreciation applies to a broader range of property.
- Qualified leasehold improvements can be depreciated over 5 years instead of the usual 39 years,
- A new targeted group (consisting of Liberty Zone workers or those relocated from the zone) is added for purposes of the Work Opportunity Credit.

If you have a business in the affected area, give us a call to see if you are eligible for any of these expanded benefits.



### And There's More...

A number of tax credits, including the Work Opportunity and Welfare-to-Work credits, which expired December 31, 2001 have been reinstated and extended until December 31, 2003. The new law includes some minor AMT relief for those who take advantage of adoption, disability, child, and education credits. And a number of technical corrections have been made to retirement plan provisions, bringing more conformity to plan rules. Changes include increasing the allowable SEP contribution deduction to 25% of compensation (up from 15%) and allowing 401(k) contributions on top of that.

Call our firm to go over other provisions not covered here and how they might benefit you.



## Mid-Year Checkup Promotes Financial Health

Does your tax liability vary substantially from year to year? Are you always on pins and needles to see where you end up at the end of the year tax-wise? Or did you have (or do you anticipate) a life-changing event this year, such as a new job, retirement, or a change in marital status?

If you answered "yes" to even one of these questions, then you probably need a mid-year tax projection. By looking at your situation now instead of waiting until the end of the year, we can help you determine

whether your withholding or estimated tax payments need to be adjusted and you can manage your tax payments to avoid underpayment penalties. This will also prevent you from cutting a large check next April, or from receiving a huge refund next year — which is essentially an interest-free loan to Uncle Sam.

### Preventive Medicine

A tax projection is gaining importance as more taxpayers become subject to the Alternative Minimum Tax (AMT). If you

are subject to AMT, some of the traditional year-end planning strategies, such as paying real estate taxes before year-end, can backfire. If you usually employ these strategies year after year, it's good to know well in advance if they may not work.

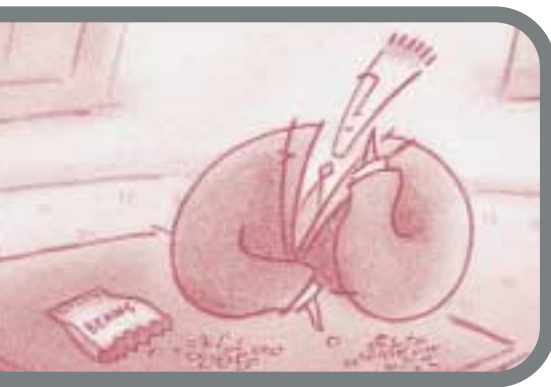
### It's A Capital Idea

A mid-year tax checkup isn't just about a tax projection to see what your liability  
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## Mid-Year Checkup Promotes Financial Health

will be. It's about planning to make that liability as small as possible.



Now is the perfect time to look at your capital gains and losses to date and determine a selling strategy for the rest of the year. Have you recognized a lot of gains so far? If so, scan your portfolio for some investments with built-in losses that you can sell to offset the gains. But remember that if you sell an investment at a loss, you must be willing to wait at least 30 days before

you can buy it back, otherwise the loss isn't deductible. Always consider the non-tax implications of selling an investment.

Have you dumped some investments this year that weren't performing well and recognized some big losses? If so, look for investments that have appreciated significantly and sell them. You can use those earlier losses to shelter your gains from the sale. And if you sell something at a gain, you don't have to wait 30 days to buy it back. This means you can sell the investment, shelter the gain with some earlier losses, and buy it back the next day if you want to. You can only deduct up to \$3,000 of capital losses in excess of your capital gains, so there's generally no reason to leave excess capital losses on the table (though they do carry over to future years).

### Be Well Educated

If you have small children, now is a good time to start thinking about contributing to

a qualified tuition program (a.k.a. 529 plan) or a Coverdell Education Savings Account (formerly education IRAs). Changes in last year's tax law have made these plans much more attractive in helping defray the escalating costs of higher education. And just like an IRA (or any tax-deferral vehicle), the sooner you fund the instrument, the more benefit you get.

### Think Long-Term

Now is a good time to start estate planning or planning for retirement, or to update your existing plans in light of the recent law changes. (See "Between A Rock And A Hard Place" on page 2.)

We don't want to ruin your summer vacation by making you think of taxes. But a little advance planning now can make your future that much brighter. We're ready for that mid-year checkup... are you?



## news and notes

### Congress Still At Work

Congress is still at work and promising more tax legislation in 2002. Who knows whether we'll have a new tax bill, or whether they'll simply add some tax provisions on to other legislation. What we do know is that the following ideas have been getting a lot of talk:

- Making the provisions of the 2001 Tax Act permanent. Many of these are now scheduled to expire in 2010.
- Providing pension reform measures in light of the Enron scandal.
- Improving IRS tax administration.
- Enhancing taxpayer protections.
- More changes to the alternative minimum tax.



### IRS Helps Fight Obesity

The IRS has weighed in on the fight against obesity, by reversing their long-held stance that obesity is not a medical condition. The Service now agrees that obesity is a disease and that weight loss costs are deductible as medical expenses. Previously, the IRS only allowed deductions for weight loss costs associated with a specific disease, such as hypertension.

You may now deduct as medical expenses the costs of participating in a weight loss program and for purchasing diet aides, such as diet plans and booklets. Food is not deductible since it's a substitute for food that would normally be consumed. This is true even if the diet foods are

things that the taxpayer would never have eaten before. Nutritional supplements are not deductible either.

As well meaning as the law is, don't expect much benefit from this new tax break. Medical expenses are still deductible only to the extent they exceed 7.5% of your AGI. Most taxpayers never exceed this limit. However, if your expenses do go over the limit, you can take the deduction in all years that are still open for adjustment. This means that you could amend your last 3 years of returns to claim the deduction. And if your employer has a Section 125 cafeteria plan, you can reap the benefits by paying for these newly defined medical expenses with tax-free dollars.

