

2005 Tax Law Changes and Money-Saving Tax Tips

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2005 saw some major changes to tax laws, which may impact your personal tax situation.

Perhaps the most dramatic is the “uniform definition of a qualifying child” for dependency, head of household, child tax credit, child and dependent care credit, and earned income credit.

If you already claim children you support who are under age 19 (under 24 and still in school), this will have little impact on your tax return.

If you have children you were unable to claim in the past because others provided more than half of the child’s support, you may see the greatest impact. Be careful, though. Because this was designed to simplify taxes, the uniform definition applies differently for each deduction or credit!

The IRS giveth, the IRS taketh away. Mileage rates were increased for 2005, initially to 40.5 cents a mile, then to 48.5 cents a mile for miles between Sept 1st and December 31st. The rate for deductible miles in 2006 will be 44.5 cents a mile.

The government deferred the reduction in the qualified electric vehicle credit/deduction. At the same time, deductions for cars donated to charity require greater reporting, and first year depreciation for cars over 6,000 lbs was limited.

There have been increases to the exemption amount (\$3,200) and standard deduction (\$5,000 single, \$10,000 married filing joint). There is also a \$500 exemption for those providing housing to survivors of hurricane Katrina.

Other increases:

- Wages subject to Social Security increased to \$90,000
- Maximum Roth/Traditional IRA contributions increased to \$4,000 (\$4,500 if over 50)
- The income levels where (deductible) contributions are limited on Traditional/Roth IRAs also increased to \$60,000 (\$80,000 if married and filing a joint return)
- 401(k)/403(b) deferral limits were increased to \$14,000 (\$18,000 if over 50) – and will increase another \$1,000 for 2006!
- The compensation limit for calculating contributions to qualified plans (including SEPs) has been increased to \$210,000, with a maximum contribution of \$42,000.
- Extension of tuition and fees deduction. A \$2,000 deduction is now available to qualified taxpayers with a modified adjusted gross income of \$65,000 to \$130,000 (\$80,000 to \$160,000 if married filing a joint return).
- Every year, the income levels where various credits and deductions are reduced is adjusted for inflation.

A new deduction is available to certain industries for domestic production. Consult your tax advisor for more information.

And my personal favorite, a higher mandatory withholding (35%) was instituted for lump sum wage payments exceeding \$1,000,000. I hope all of you were adversely affected by this one!

New Year's resolution 2005 – Pay less taxes!

Some commonly missed deductions:

- Fair market value of items given to charity.

Various calculators are available to help you determine what your contributions are really worth. Remember that you are allowed the value of the item if sold by a willing seller to a willing buyer – think thrift store prices . . . not garage sale.

- Unamortized points.

If you sold a house or refinanced this year you may have had points on your previous mortgage that you had not previously claimed. You can deduct any remaining unamortized points when that mortgage is paid off.

- New Sales Tax Deduction (or old, if you remember that far back).

Since tax year 2004, taxpayers have had the option of deducting either their sales taxes paid or their state and local (in California, SDI generally qualifies) income tax withholding and payments. If you don't have records (and even if you do) tables are available from the IRS based on your income, filing status and exemptions claimed. You can add sales tax on car purchases to the table amount. You will want your tax practitioner to check which is better for you.

- Basis of items sold at a profit.

Capital gains taxes only apply to the difference between the selling price and "basis" price of an asset. Your basis is generally what you paid for the item (including commission). However, in the case of employee stock options, you may add taxable income already reported on your W-2 to your basis. If you buy and sell securities, good records are vital to paying no more tax than you are required to.

- Deductible mileage expenses

Not just mileage from one workplace to another, but mileage to qualifying temporary job locations can be deductible. The IRS requires that you keep contemporaneous records of your mileage (mileage log, calendar). For vehicles placed in service after January 1, 2004, small businesses can use the standard mileage rate for up to 4 vehicles at a time. Also, miles you drive for medical care or to volunteer are deductible on Schedule A as medical or charitable expenses (at 15 cents a mile).

No tax information will fit every individual tax situation. For questions on how the information below affects your tax situation, please contact your tax advisor. Also, while we believe this information to be accurate at the time of writing, no guarantee is made, and absolutely no guarantee is made that it hasn't changed since then!

If you have questions, please feel free to contact us at (760) 868-0901 or visit our website at www.sosbusinessservices.com.

Happy New Year!