

# TAX TIME NEWS

## Year-End Tax Planning for 2001

Year-end tax planning is increasingly important to a growing number of taxpayers. The days in which these strategies were reserved for the super-wealthy have long passed. Good reasons exist for most middle-class and higher-income taxpayers to investigate a variety of year-end tax options.

This year, in addition to a growing list of "tried-and-true" year-end tax strategies, tax changes brought about by the Economic Growth and Tax Relief Reconciliation Act of 2001 have added to the opportunities available to you. Careful timing of your financial transactions now and in January may help you realize significant overall tax savings. Most of these tax benefits, however, won't just "happen" to you. You must take action to effectively use many of these changes.

Here's an abbreviated list of some of the tax opportunities, and challenges, that await you during your year-end tax planning:

- Tax rates have dropped 0.5 percent in 2001 and will drop again by 0.5 percent in 2002, from the former 28, 31, 36 and 39.6 percent income tax brackets;
- Starting in 2002, the annual contribution limit for individual retirement accounts (IRAs) increases to \$3,000, with those 50 and older allowed to make special "make-up" contributions;
- Starting in 2002, Coverdell Education Savings Accounts (formerly known as education IRAs) can accept up to \$2,000 each year, up from \$500 in 2001; qualified state tuition programs are also made much more generous;
- The alternative minimum tax (AMT) exemption increases for 2001 and 2002 by \$4,000 for joint filers and \$2,000 for others;
- The estate tax begins its slow decrease starting in 2002, requiring many taxpayers to draft new will provisions while adopting new gift-giving strategies. If your estate plan involves using a credit shelter trust (also known by other names, such as a *family trust*), then you should consult with your estate planner immediately. With the increase in the amount of your estate that you can pass tax free, you may be impoverishing your surviving spouse if you do not adjust your estate plan. Unfortunately this may require annual updates or an extremely well crafted will;
- A new reduced rate on long-term capital gain for property held for more than five years started in 2001, giving a new --and sometimes complicated-- twist to buy-sell decisions this year end;
- The maximum student loan interest deduction rose from \$2,000 to \$2,500 starting in 2001, and in 2002, the income phase-out limits increase;
- The IRS continues its massive reorganization, creating not only new rules for taxpayers who anticipate trouble with the IRS, but also new opportunities to "audit-proof" this year's tax returns through year-end and pre-filing strategies.



## Year-End Tax Planning for 2001 (continued)

In addition to the pressing year-end issues generated by recent legislation, many "tried-and-true" year-end tax strategies have particular relevance this year. Here is an overview of some of the more important technique that may be used:

- Time your income and deductions so that your taxable income is about even for 2001 and 2002. If you anticipate being in a higher tax bracket for 2002 (even with the drop in the tax rates caused by the 2001 Tax Relief Act), accelerate income into 2001 and defer deductions into 2002. Income can be delayed through setting up deferred compensation arrangements, postponing year-end bonuses, maximizing deductible retirement contributions, and delaying year-end billings.
- Maximize the value of itemized deductions between 2001 and 2002. Some taxpayers achieve this balance by taking the standard deduction one year and paying all bills that generate itemized deductions in the other year (care must be taken, however, not to run afoul of pre-payment rules). Other taxpayers must carefully watch whether their itemized deductions for medical expenses will exceed the 7.5 percent adjusted gross income floor, or their miscellaneous itemized deductions exceed the designated 2 percent floor. Still others may need to balance income if they anticipate exceeding the income level above which certain itemized deductions must be reduced (\$132,900 in 2001, rising to \$137,300 for 2002);
- Compute whether you are in danger of being subject to the alternative minimum tax for 2001 or 2002 (a growing number of "average" taxpayers are). If necessary, investigate whether certain deductions should be more evenly divided between 2001 and 2002 and whether certain deductions won't qualify --or won't be as valuable-- for AMT purposes;
- If you're in business, consider timing final quarter equipment purchases to capitalize on "half-year" and "mid-quarter" conventions; and space the purchase of depreciable assets to take full advantage of the \$24,000 immediate write-off allowable for each year, in 2001 and 2002.
- Time the recognition of capital gains and losses to minimize net capital gains tax (and maximize deductible capital losses). This involves an often complicated process of determining short term gains (taxed as ordinary income), long-term gains, short-term losses, long-term losses, depreciable gain, and gains and losses from collectibles, and then determining how you might vary the mix before year-end to maximize existing losses and minimize existing gains. Adding to the confusion for 2001, will be an 8% capital gains rate for 15% income tax bracket taxpayers realizing long-term capital gain from property held for more than five years, and an 18% rate available beginning in 2006 (but subject to a 2001 election) for other taxpayers.
- As in 2000, the value of many mutual funds has dropped. Due to the redemption of shares by your fellow mutual fund owners, your mutual fund may be distributing rather large capital gains even though the overall value of your investment is down. It is possible, in the right circumstances, that selling a mutual fund may result in a loss that partially offsets this phantom income.



Good tax planning can save you money!

## Year-End Tax Planning for 2001 (continued)

- Income shifting between low-bracket family members and higher-bracket members usually starts with transferring income-rich assets before the start of another tax year, followed by careful timing of year-end sales to maximize use of the lower tax bracket.

In addition, changes in circumstances, such as marriage, divorce, the birth of a child, death, retirement or an economic windfall (or set back) through the stock market, earnings or inheritance, may signal a special need for year-end tax planning. Once January 1, 2002 rolls in, however, it will be too late to alter most of your bottom-line tax liability for 2001 due to these, or other "more ordinary" events.

Some "year-end" tax strategies can be implemented in a matter of days, but others may take a month or more to customize properly to fit particular needs. If you are interested in investigating what year-end tax planning will work best in your situation, please contact this office early enough to allow full consideration of the options available. Before implementing any of the ideas discussed in this letter, please consult with us. Implementing these ideas without consultation could, under some circumstances, result in additional income tax.

## RECORD RETENTION POLICY

### Going Paperless (sort of) and our

#### Record Retention Policy

In order to improve customer service and reduce storage costs, we have begun scanning our client's tax files. Having client tax files stored electronically will allow us to easily fax or e-mail copies of your return or supporting documents to you.

Client bookkeeping files will NOT be scanned and stored electronically. It is therefore essential for you to retain copies of all of your financial statements, payroll returns, sales tax returns and other documents we prepare for you.

The Internal Revenue Service has strict rules regarding the electronic storage of paper documents. Due to the costs involved, our electronic copies will not be maintained in accordance with Internal Revenue Service requirements. We have always returned your original documents to you and have informed you that you are responsible for maintaining the records required in the event of a tax audit or other investigation. We do not currently, and have never, retained copies of all of your records.

After November 20, 2001 we will be destroying paper files for years prior to 1998. Our policy is to retain only the four most recent years in paper. Each fall we



#### Electronic storage of your data will lessen the burden of record retention!

will destroy the appropriate prior year's file(s). All of these files will still be maintained electronically.

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### **New Office Hours:**

Effective August 31, 2001, outside tax season, we will close at 1:00 on Fridays. Please keep this in mind before stopping by our office. As most of you know, we have a rather small office staff outside tax season. Occasionally no one will be in the office, especially during lunchtime. Please call ahead to be sure someone will be here if you are coming by the office.

## **TAX CALENDAR 2001-2002**

**Last Quarter, 2001**—Time to do tax planning for 2002. After December 31, 2001, it is generally too late! Call now for your appointment.

**December 31, 2001**—Make sure any state tax payments for individual income taxes, such as fourth quarter estimated payments, or county property taxes, are made by this date to be deductible in 2001. Any other items to be deducted in 2001 must be paid by this date.

**January 15, 2002**—Fourth quarter estimated payments for 2001 are due for taxpayers with December 31 year end. January 31, 2002—All payroll forms are due to employees (W-2s, 1099s) as well as Forms 940 and 941 to the IRS, and state withholding and unemployment re-

turns to their respective agencies. Business property tax listings are due to the county.

**February 28, 2002**—All year-end payroll forms are due to the federal government (W-2s, W-3s, and 1099s)

**March 15, 2002**—Due date for 2001 corporate tax returns with December 31, 2001 year-end. Due date for extension of these returns also, as well as payment of any tax owed.

**April 15, 2002**—Due date for individual and partnership returns for 2001, as well extensions of these returns and any tax due. Also due date for first quarter estimated payments for 2002 for taxpayers with December 31 year end.