FALL 2004

Quill

NEWSLETTER

As this Holiday Season approaches, we THANK YOU for letting us work with you! Our best wishes to you for a Healthy and Prosperous New Year.

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New Tax Laws

Simplification? Not yet.
Complication? You be the judge.
By Amy Rossignol, Senior

Just prior to their adjournment for the November election, Congress passed two new tax packages: **Working Families Tax Relief Act of 2004 (WFTRA) and American Jobs Creation Act of 2004 (AJCA)**. Combined, the acts change 755 sections of the Internal Revenue Code and total over 700 pages, thus we can only scrape the surface here.

Some of the features of **WFTRA** that might interest our readers include:

- Extending through 2010 the following, that would have otherwise expired at the end of 2004:
  - √ Removal of the so called '**marriage penalty**' in the standard deduction and 15% tax bracket.
  - √ Expansion of the 10% tax bracket.
  - √ Keeping the child credit at $1,000.
- A one-year extension of the limited relief brought by the increase in the **Alternative Minimum Tax** exemption amount.
- Five different definitions of 'child' have been consolidated.
- Extension to 2004 and 2005 the $250 above the line deduction for teachers who expend their own funds for classroom supplies.
- **Two for the environment**: Extension to 2004 and 2005 the tax credit for a Qualified Electric Vehicle and the 10% deduction (up to $2,000) for the purchase of a 'qualified clean-fuel vehicle'. Clean fuels include: natural gas, LNG, LPG, hydrogen, electricity, methanol, ethanol, alcohol, and others.
- Extension of many business tax credits to 2004 and 2005.
- **Military** families will benefit from having **combat pay** used to figure income for purposes of qualifying for the earned income and child tax credits.

AJCA started out as legislation to help exporters affected by the prohibitive sanctions imposed by the EU. However, like the Energizer Bunny, it kept going and going until it ended up being the biggest tax overhaul since 1986, with a plethora of permanent and temporary provisions. A slim list of selected Act provisions:

- Extension of the Section 179 **expensing provisions** for two more years to 2006 and 2007. The expensing limit is inflation adjusted to **$102,000** in 2004 and the investment limitation is likewise adjusted to $410,000.
- A bummer for the Hummer. JGTRRA 2003 allowed an expensing deduction of up to $100,000 for the business use of SUV's with a gross vehicle weight of greater than 6,000 lbs. Consequently, many manufacturers added weight to their vehicles and many taxpayers 'bought up'. Post 10/22/04 purchases of **SUV's are limited to a $25,000 expensing election** vs. the $102,000 noted above. Pick up trucks are removed from the SUV definition.
- Tougher rules, documentation, and limits for the **charitable donation of motor vehicles, boats, and aircraft** with a fair market value of $500 or more. Rules affect both donor and donee. Whether the vehicle is kept and used or sold by the charity has an impact.
- An option to deduct state and local sales taxes OR state and local income taxes. This helps those living in states with sales taxes but no state income tax.
- **Qualified leasehold improvements and qualified restaurant property** will now be depreciated over 15 years versus 39 years for post 10/22/04 and pre 1/1/06 additions.
- Immediate deduction for up to $5,000 in **business start-up expenses**.
- An increase in the maximum number of **S-corp shareholders from 75 to 100** and all members of one family can elect to be treated as one.
- The IRS may now use private debt collection agencies to collect certain tax debts.
- A tightening of rules surrounding '**tax shelters**'.
- The law is packed with **special interest tax breaks** and touches a myriad of topics from tackle boxes and bows and arrows, to occupational taxes on alcohol, Alaskan subsistence whaling, dog and horse wagers made by non-resident aliens, and a suspension of a tax on the import of ceiling fans. It adds 34 new Internal Revenue Code sections and affects 274 others.

State non-comformity? Stay tuned to the upcoming legislative session for probable state decoupling with IRS rules.

Married Filing Jointly Tax Brackets				
2005 with New Law			2005 without New Law	
2005 Taxable Income	Tax Rate		2005 Taxable Income	Tax Rate
$0-14,600	10%		$0-12,000	10%
$14,601-59,400	15%		$12,001-53,450	15%
$59,401-119,950	25%		$53,451-119,950	25%
$119,951-182,800	28%		$119,951-182,800	28%
$182,801-326,450	33%		$182,801-326,450	33%
Over $326,450	35%		Over $326,450	35%
Standard Deduction				
Married Filing Jointly				
2005 with new law				$10,000
2005 without new law				$8,700
Married Filing Separately				
2005 with new law				$5,000
2005 without new law				$4,350
10% Bracket Level				
2005 with new law				$14,600 or 7,300
2005 without new law				$12,000 or 6,000
Child Tax Credit				
2005 with new law			$1,000 per qualifying child	
2005 without new law			$700 per qualifying child	
Alternative Minimum Tax				
2005 with new law			$58,000 or 40,250 AMT exemption	
2005 without new law			$45,000 or 33,750 AMT exemption	

**Source: CCH Tax Briefing, September 23, 2004

Tax Planning 2004 – Final Phase
Tax Planning 2005 and beyond – Interim Phase

By Jack Sullivan, Principal

The tax changes regarding the two October Tax Acts (highlighted in Amy's article on page 1) add dimension to planning process this year. Here are some of the more important issues to consider:

- Is tax planning **important**? Yes. Does my doctor not smoke? Absolutely! Does my dentist floss? Yes, daily! Do we engage in year-end tax planning as individuals and as a firm? You bet!
- Tax planning is a multiple step process that begins with knowing your **marginal tax rate**, the rate at which your next dollar of income will be taxed or the rate at which an additional deduction will benefit you. The idea, of course, is to level off brackets between years so that income is kept out of higher brackets. Likewise, postponing taxes allows you to take advantage of the time value of money.
- However, thanks to the continued growth in the application of the Alternative Minimum Tax (**AMT**) to more rank and file taxpayers (not just the sophisticated planners, investors, and strategists that it was designed to catch) the task is not as easy as it once was. AMT is like a tax return cholesterol; if undetected it can undermine otherwise smart tax moves that have been made.   The most common deductions that are wasted if AMT applies are emotionally the hardest ones to lose for most Mainers, due to the highly publicized tax woes of our state: state income tax, property taxes, and excise taxes. In addition, certain home mortgage interest and medical expenses can be lost forever as tax benefits if AMT applies.
- The first step is to start **gathering** your tax data for this year, **look** to where the data may fall for next year, and **sketch** out your taxes. The results will open up opportunities to save and/or postpone taxes on a federal and state level.

- **Review Your Investment Portfolio.** Do you have losers that you should have shed by now? Will you have mutual fund gains that will be reported even though you did not sell the fund? Do you have the opportunity to harvest $3,000 of excess capital losses to offset ordinary income? Remember: the long-term holding period for the more favorable capital gains rates is one year so watch your holding periods. You might also consider whether dividend-paying stocks make more sense in light of the lower tax rate on dividends. Review your investment portfolio with an eye toward diversification and rebalancing. Using stock proceeds to fund an education? Consider gifting the stock (watch for gift tax limits) to the child and have them sell it. Perhaps the tax can be 5% versus 15%.
- **Selling your home?** Watch the holding period. Meeting the rule of owning and living in your home as a primary residence for two of the last five years to avoid taxable gains can be planned for.
- **Retirement planning.** Statistics show that most Americans are in for an eye opener when they retire, thanks to living beyond their means, the debt they have racked up, longer life expectancies, and the explosion of health care costs. Planning has to start today. Take advantage of IRA's, 401(k)'s, 403(b)'s, SIMPLES, SEP-IRA's and the like. Ignoring reality is a mistake.
- **Write off More Business Assets.** The last four major Tax Acts include provisions especially attractive to business owners. The so-called Section 179 **expensing deduction** discussed on page one is of vital consideration for business owners. Even if new property additions don't qualify for the Section 179 deduction, favorable depreciation rules may apply. For qualified property acquired and placed in service prior to January 1, 2005 an upfront **bonus depreciation** rate of 30% or 50% is available. That's an immediate deduction 30 to 50% of the cost. Regular depreciation is available on the remaining basis. Only new property qualifies, but certain leasehold improvements are eligible in additional to tangible personal property. Both the Section 179 deduction and bonus depreciation can be claimed for property placed in service anytime during the tax year, including the last day. Bonus depreciation was not extended by the 2004 tax acts; it is gone after 12/31.
- **Defer Income and Accelerate Deductions or vice versa if appropriate.** Cash-basis proprietors might accelerate or defer year-end billings or accelerate or defer business expenditures. If you itemize your deductions, the timing of paying charitable donations, state and local taxes, and medical/orthodontic expenses can be manipulated. Where there are limits due to percentages being applied to Adjusted Gross Income, consider bunching expenses into one year. Paying by credit card counts for cash basis tax payers.
- **Charitable gifts.** Consider making year-end charitable gifts to reduce your taxes. Non-cash contributions (clothing, furniture, books, vehicles, etc. can also lower your taxes; be sure to get receipts and watch limits for additional documentation/appraisals. Gifting appreciated assets (e.g. stocks) is a good way to bypass the capital gains tax that would be due if you sold them.
- **Like-kind-exchanges** are worth considering if you are interested in getting rid of trade or business or investment property and replacing it with other like-kind property. Taxes can be postponed (but not avoided). Note inventory and stocks and bonds do not qualify for such exchanges.
- **Some numbers to ponder for 2005:**
    - √ The 2005 Social Security wage base is $90,000.
    - √ The gift tax exclusion remains at $11,000.
    - √ Elective deferrals for 401(k)'s and 403(b)'s increase to $14,000 (+$4,000 if over 50).
    - √ SIMPLE plan deferrals increase to $10,000 (+$2,000 if over 50).
    - √ Federal estate tax exclusion remains at $1.5M.
    - √ Lifetime gift tax exclusion remains at $1M.
    - √ State estate tax exclusion increases to $950,000.
- **Bottom line:** make a commitment to start soon, fine tune before you indulge in Thanksgiving festivities, wrap up by Christmas, and mail any final payments on your way to your New Year's Eve party.

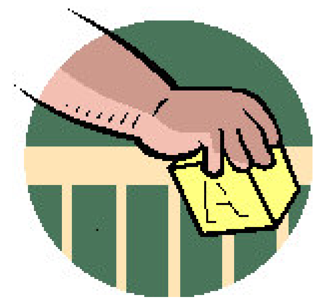
RKO welcomes **Janet H. N. Hyslop** as a staff accountant. Janet graduated with a B.S. in accounting from Husson College, and is 2 classes away from earning her MBA from Thomas College. For the past 9 months she's been working for another local firm as a staff accountant. Most of her experience has been with taxes, compilations and reviews. Janet has worked on several small nonprofit and pension audits as well. She started with RKO on September 20th.

Thomas R. Emery CPA, MBA joined the managerial ranks of RKO's South Portland office during the last week of November. Tom attended USM for both his undergraduate accounting degree and his masters degree. He was previously a principal in another Portland accounting firm where he served as director of accounting services and was heavily involved in accounting and tax compliance. Tom brings with him a wide range of accounting and tax skills, many of which were acquired earlier in his career right here at RKO where he worked as a senior accountant. While here, Tom was active in both audit and tax compliance. In addition to his client duties, Tom has been the coordinator for his firm's successful Peer Review efforts. He will be an integral member in the for-profit department of RKO, servicing the reporting and tax needs of businesses and individuals. We all welcome Tom, who along with his wife Celeste and three children, make their home in North Yarmouth.

NEW ARRIVALS

Peter McPartland, a Senior Accountant, has a new addition to his family - on October 7th, Joseph Lech was born at 3:11pm. He was 9 lbs. 9 oz. and 22 inches. Congratulations Peter and Jenna!

Meghan Rochefort, the Tax Department Assistant in our South Portland office, had a daughter, Morgan Marie, on July 22nd at 12:46pm. Weighing in at 8 lbs. 13 oz. and 20.5 inches long. She has red hair and blue eyes and looks just like her mom. Congratulations to Meghan and her husband Scott!



Nancy Jeannotte, in our Waterville office, welcomed a new grandson, Thomas William Tieman on August 30th. He weighed 7 lbs. 14 oz. and was 20 inches long.

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