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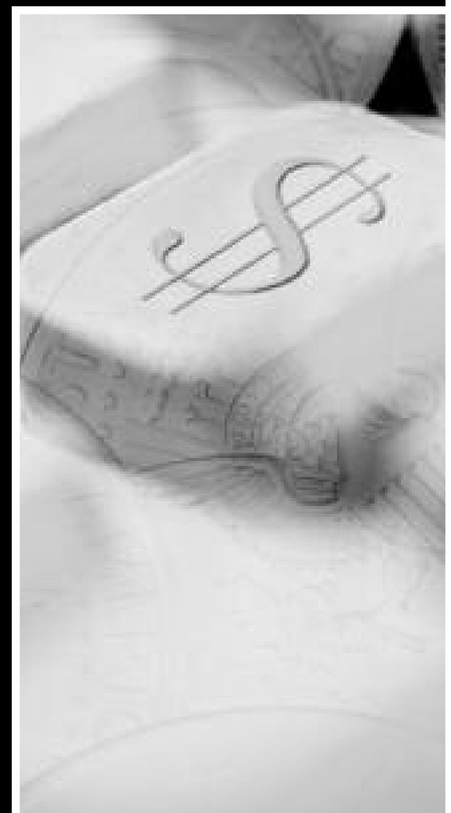
Tax Saving
Tips for 2005



Advice from CPAs

Tax Planning for 2005

In the last few years, numerous tax law changes have been introduced that affect individuals. This guide provides information about these changes and important new tax law provisions to help you prepare your return and minimize your 2005 tax bill.

Health Savings Accounts (HSAs)

Individuals not eligible for Medicare may be able to take advantage of health savings accounts (HSAs). Used in combination with a high deductible health insurance plan (an annual deductible of at least $1,000 for individuals and at least $2,000 for family coverage), HSAs are tax-favored savings plans in which individuals make deposits to pay qualified health expenses. Employers can also contribute to HSA plans on behalf of employees. Contributions are tax-deductible and earnings and interest grow tax-free. Distributions are not taxable as long as the funds are used to pay for qualified medical expenses. Contributions are limited to the lesser of the health plan's annual deductible or $2,650 for individuals and $5,250 for families. Unused contributions and earnings can be carried forward to pay for future years' medical expenses.

Tax Benefits Extended

- The maximum child tax credit is $1,000 per child for tax years 2005–2010.
- The size of the 10 percent income tax bracket is extended through 2010.
- The standard deduction for married taxpayers filing jointly is twice the single standard deduction through 2010.
- The 15 percent rate bracket for married taxpayers filing jointly is twice that of single filers through 2010.
- The $58,000 Alternative Minimum Tax (AMT) exemption for married couples ($40,250 for single individuals) is extended through 2005. In 2006, exemption amounts will return to 2000 levels.

New Tax Provisions Help Military

Members of the military, National Guard, and Reserve may now elect to include tax-free combat pay in their earned income when calculating their refundable child tax credit and earned income credit.

"Qualifying Child" Defined

A uniform definition of a "qualifying child" applies to major child-based tax benefits: dependency exemption, child credit, earned income credit, dependent care credit, and head-of-household filing status. Beginning in 2005, the "residency" and "relationship to the taxpayer" tests will be consistent. However, different age limits will still apply.

Filing Basics

Filing Status

Taxpayers can file as single, married filing jointly, married filing separately, head-of-household, or qualifying widow(er). If you are married and filing jointly, you can take advantage of tax credits and benefits not available to couples filing separately. Unmarried taxpayers may file as single or, if they qualify, as head-of-household.

Exemptions

You may claim a personal exemption for yourself, your spouse, and each of your dependents. Each exemption reduces your taxable income by $3,200 for 2005. You lose all or part of the exemption benefit if your adjusted gross income (AGI) is above the following:

2005 Exemption Phase-Out

– Single — $145,950
– Married filing jointly/Qualifying widow(er) — $218,950
– Married filing separately — $109,475
– Head of household — $182,450

Deductions

Even if you don't itemize, you can deduct IRA, Keogh, and SEP contributions; student loan interest; one half of self-employment tax; alimony; qualified tuition and fees; education expenses; job-related moving expenses; and self-employed health insurance premiums.

In addition to above-the-line deductions, you can claim the standard deduction or itemize. The basic standard deduction for 2005 is $5,000 if single or married filing separately, $10,000 for married filing jointly, and $7,300 for head of household. If your total allowable itemized deductions are larger than the standard deduction, you should itemize.

The value of some of your deductions will be reduced by three percent if your AGI is above $145,950 ($72,975 if married, filing separately.) Beginning in 2006, the limit on itemized deductions will be phased out until it is eliminated completely in 2010.

The American Jobs Creation Act of 2004 gives taxpayers the option of deducting either state and local income or sales taxes on their 2005 returns. However, the AMT may eliminate the benefits of this and other deductions.

Tax Breaks for Homeowners

Interest and Property Taxes

Home mortgage interest on up to $1 million of home acquisition loans secured by your principal home and/or second residence is fully deductible. You may also deduct mortgage interest on a home equity loan or line of credit (up to $100,000). Points paid to secure a loan for the purchase or improvement of a principal residence are usually fully deductible in the year you pay them. Points paid to refinance an existing mortgage must be deducted over the life of the loan. Real estate taxes and state and local property taxes on all your real estate are deductible.

Exclude Capital Gains

When you sell your principal residence, you can exclude from income up to $250,000 in gains ($500,000 if married and filing jointly). To qualify, you must have owned and used your home as a principal residence for at least two years during the five-year period ending on the date of sale. The full tax break is available once every two years.

Tax Breaks for Investors

Long-Term Capital Gains and Dividends

The maximum tax rate on net long-term capital gains is 15 percent. For taxpayers in the 10 or 15 percent tax brackets, net long-term capital gains are taxed at five percent. To qualify as a long-term capital gain, the asset must be held for more than one year before selling. Capital gains on investments held for one year or less are taxed at regular income tax rates — as high as 35 percent. For collectibles held for more than one year, the maximum capital gains tax is 28 percent.

Likewise, qualified dividend income from a domestic or qualified foreign company is taxed at a top rate of 15 percent (5 percent for taxpayers in the 10 and 15 percent tax brackets).

Offset Capital Gains with Losses

Net capital losses are fully deductible against capital gains. If your capital losses exceed your capital gains, you can deduct up to $3,000 in net capital losses against ordinary income ($1,500 if married filing separately). Any remaining capital losses may be carried over to the next year.

Retirement Savings Tax Breaks

Individual Retirement Accounts (IRAs)

You may contribute up to $4,000 to fund a traditional or Roth IRA for 2005 and 2006. Those ages 50 or older can make an additional catch-up contribution of $500 for 2005, and $1,000 for 2006. Traditional IRA contributions may be deductible depending on your AGI and whether you or your spouse, if filing jointly, are covered by an employer's pension plan. Roth IRA contributions are not deductible, but the earnings accumulate tax-deferred and may be withdrawn tax-free if you meet the qualified distribution requirements. Eligibility to contribute to a Roth IRA is phased out as AGI rises from $95,000 to $110,000 for single filers, and $150,000 to $160,000 for joint filers.

Employer-Sponsored 401(k)

Pre-tax contributions to employer-sponsored retirement plans reduce your taxable wages. Matching contributions and income earned within your plan are also tax-deferred. The employee contribution limit for 2005 is $14,000. The limit increases to $15,000 in 2006. Employees age 50 or older may make an additional catch-up contribution of $4,000 for 2005 and $5,000 for 2006.

Don't Miss the Ball on These Deductions

- *Student loan interest*
- *Penalty for early withdrawal of savings*
- *Alimony*
- *Charitable contributions — cash, property, and donated clothing or household items*
- *State and local income taxes and personal property taxes*
- *Points paid for mortgage or refinancing*
- *Mileage and other expenses associated with volunteer work*
- *One-half of self-employment tax*
- *Casualty and theft losses*
- *Income tax preparation software and fees**
- *Job search expenses**
- *Investment expenses**
- *Unreimbursed employee business expenses**
- *Prescription eyeglasses, contacts, and hearing aids***
- *Crutches, canes, and orthopedic shoes***
- *Medical transportation***
- *Cost of alcohol or drug abuse treatment***

* Deductible as miscellaneous itemized deductions to the extent the total exceeds 2% of AGI.

** Deductible to the extent the total of all medical and dental expenses exceeds 7.5% of AGI.

Child/Education-Related Tax Breaks

Child Tax Credit

The Child Tax Credit allows you to reduce your federal income tax by $1,000 for each qualifying child under the age of 17. This credit begins to phase out if your modified AGI is above $110,000 for joint filers, or $75,000 for single or head of household filers.

Dependent Care Credit

Parents who must pay for the care of a dependent under age 13 in order to work may be eligible for a tax credit of between 20 and 35 percent of qualifying expenses. For 2005, the maximum amount of expenses on which the credit can be claimed is $3,000 for the care of one dependent or $6,000 for two or more.

Tuition Deduction and Student Loan Interest

For 2005, a deduction of up to $4,000 is available for higher education tuition and qualifying fees. You qualify for the maximum deduction if your modified AGI is under $65,000 for single filers and $130,000 for joint filers. This deduction phases out for single filers with AGIs between $65,000 and $80,000 and for joint filers with AGIs between $130,000 and $160,000.

For 2005, taxpayers whose AGI falls into qualifying limits can deduct up to $2,500 in student loan interest, regardless of whether they itemize.

Education Tax Credits

Two popular credits can help defray the cost of education. The Hope Credit, worth up to $1,500 for each qualifying student, is available for each of the first two years of college. A Lifetime Learning Credit of up to a maximum of $2,000 can be used by anyone for undergraduate, graduate, and professional degree courses. Both credits are phased out as modified AGI increases from $87,000 to $107,000 for joint filers and from $43,000 to $53,000 for single filers. You cannot claim both credits for the same student in the same tax year.

Information is current as of December 1, 2005.