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October 2001 - SAVE BIG ON TAXES BY PLANNING SEVERAL YEARS IN ADVANCE!

It has always been prudent to look at more than the current year when planning your life to pay the least legal amount of tax. The newest tax law, titled "The Economic Growth and Tax Relief Reconciliation Act of 2001", makes multi-year tax planning much more important than ever before. This law, which was signed by President Bush on June 7, gradually phases in its changes over several years. The result is that you will want to carefully consider which year (or years) you want to claim each item in. Patience has always been a virtue. It is vital now!

Traditional Tax Timing Tips That Still Work

Pay medical expenses from two consecutive years in the lower income year of the two. Most people are not able to claim medical expenses on their tax returns, because their total medical expenses do not exceed 7.5% of adjusted gross income. Medical expenses are claimed in the year they are paid. Schedule elective surgeries and other medical procedures so that the payment is due in the year with the lower income. Get any needed dental work, eye exams, etc. done and paid for in this same year. The lower income will make the 7.5% limit lower, so more deductions can be claimed. For example, suppose your family income is \$36,000 in one year and rises to \$40,000 the next year. Let's also assume you have \$2,000 in total medical expenses, including payroll withholding for medical insurance, in each year. This \$2,000 is less than 7.5% of income each year, so no deduction will be available in either year.

By paying the full \$4,000 in medical expenses in the first year, a deduction of \$1,300 is allowed. This is computed by multiplying the \$36,000 income by 7.5%, which makes the non-deductible portion of medical expense equal to \$2,700. Subtract this \$2,700 from the \$4,000 of medical expense paid to determine the \$1,300 deductible amount. Notice that waiting to the second year to pay the \$4,000 in medical expenses reduces the amount that can be deducted to \$1,000. Of course, this is still better than paying in the same year and receiving no deduction at all. Keep in mind that medical expenses paid by credit card count in the year charged, not the year the credit card bill is paid.

Use a spreadsheet to look at income and deductions in several years, and apply the tax rates and credits that apply to each year, to anticipate what the tax liability will be. Try moving items from one year to another on the spreadsheet to see what the effect will be on the total tax paid in all the years. For example, if you need to buy tools for your job and you are eligible for a year-end bonus, try asking your employer to pay you the bonus in January (when the tax rate will be a little lower than December). Then plan to buy the tools in December, when more of the purchase price will exceed the 2% of income threshold for deducting employee business expenses. Keep experimenting until you get the best combination. Sometimes a difference in tax brackets from one year to the next will make a bigger impact than the amount that is deductible over a threshold such as the 7.5% medical or the 2% employee business expense limits we have just discussed.

Examples of How The New Tax Law Phases in Benefits. There are numerous parts of this tax law that are phased in over several years. The benefits of one part will sometimes enhance the benefits of another part. In other situations, one part may decrease the benefit of another part.

Planning using a spreadsheet that considers as many of these components as possible is key to obtaining the full benefit of this new law. It can make a difference of hundreds or thousands of dollars of tax paid.

There are more aspects to this law than can be discussed in a single article. In this article, tax table changes as well as changes to the child tax credit and student loan interest will be discussed. The next article will look at changes in itemized deduction and personal exemption phase-outs, education IRAs, education expense deductions, and changes in IRAs and other retirement savings plans. Future articles will consider more of the tax law changes.

Child Tax Credit. This credit is allowed to parents who have dependent children who have not reached age 17 by December 31 of each year. The credit phases out for parents with adjusted gross income over \$110,000 if married filing jointly or over \$75,000 if single.

The credit amount is \$600 per child until 2004. It increases to \$700 per child in 2005, then to \$800 per child in 2009, and one more time to \$1,000 per child in 2010 and beyond.

The credit has been refundable for parents of three or more children under 17. First the credit is used to offset all income tax. If there is still an unused portion of the credit, then it can be claimed up to the amount that social security tax exceeds the earned income credit.

This continues to be true, but there is an additional planning opportunity. The credit is now refundable for parents of one or more children under 17. This is done by subtracting \$10,000 from earned income and multiplying the result by 10%. The result is the refundable amount of the credit. The \$10,000 amount will be indexed for inflation each year beginning in 2002. The 10% amount will be increased to 15% beginning in 2005. And parents of three or more children under 17 will get to choose between the method outlined in this paragraph, or the one in the previous paragraph.

The child tax credit will also now be allowed to reduce alternative minimum tax as well as regular income tax.

Student Loan Interest. Currently, you cannot deduct student loan interest paid after the first 60 months. Beginning in January 2002, there will not be a time limit. If your payment is high and you are already past the current 60-month limit, you might want to consider asking for permission to double up your December and January payments to the beginning of January so that you will receive the deduction for the December interest payment.

The information in this article is intended to inform you of some of the tax savings opportunities available in the 2001 tax law. It is not intended to give you specific tax advice for your personal situation. If you need such advice, please contact a qualified professional!

If you have a question you'd like to have answered in a future article, please contact me in care of the **Hurricane Valley Journal.**