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April 2004 - Tax Planning for Capital Gains and Dividends.

In 2001, federal capital gain tax rates were lowered by five percentage points to 15% for most people. Some are enjoying an even better rate of 5%. Last year, these rates were expanded to include many types of dividend income. On the sale of a real estate parcel with a \$100,000 gain, this can produce savings of up to \$5,000. On dividend income of \$1,000, the new law can reduce taxes by as much as \$200, or 20%!

If this all sounds too good to be true, well maybe it is. There are at least two good reasons you will want to do some tax planning if you expect to have either capital gain or dividend income this year. If you are thinking about transferring money from investments producing interest income at low rates to new investments that will pay dividend income so you can take advantage of the lower tax rates, you will also need to do tax planning as part of your investment decisions.

The two things that can affect your potential tax savings is the alternate minimum tax and the investment interest expense deduction. Avoiding the problems they can create is complicated. If you will take the time to calculate potential taxes using many different options, you can save thousands of dollars. Accordingly, if you need help to make these calculations, in this case it can be well worth it. I will briefly describe both tax challenges here, so that you can get help if you need it.

Alternate Minimum Tax

The alternate minimum tax (AMT) is designed to assure that people with many deductions, credits, or tax benefits such as the lower capital gains tax rate still pay what Congress considers to be a fair amount of tax. For a full description, get a copy of IRS Form 6251 and its instructions. In summary, what the AMT does is add some or all of these deductions, credits, and tax benefits back to taxable income, and taxes them at rates of 26 to 28 percent. If the AMT is higher than regular tax, then you pay the AMT.

For a long time, most people weren't concerned about the AMT because they perceived it only affected the very highest income people, not them. Recently, I am seeing many surprised people who get hit with high AMT bills when a large, once in a lifetime event occurs. Get a computer program (and the help of someone who really understands the program if you need it) to try many different possibilities on the AMT while you are still considering how and when to sell a large item.

Investment Interest Deduction

If you borrow money for investment purposes, you can usually deduct the interest on this debt from your taxable income up to the amount of your investment income. This has been modified in the laws lowering the capital gain and dividend tax rates. The portion of your investment income that benefits from the new lower tax rates is offset against the amount that allows investment interest to be deducted. In some cases, the investment interest deduction is worth more than the lower tax rate. Accordingly, you are allowed to choose to use ordinary income rates rather than the new capital gain rates. Again, what this means is that many calculations may need to be done to determine what is best for you.

Important Note!

The information in this article is intended to inform you of some of the financial opportunities provided in the tax laws or elsewhere. It is not intended to give you specific advice for your personal situation. If you need such advice, please contact a qualified professional! Please call or e-mail me (doug@accuteksolutions.com) for an initial consultation to discuss your personal situation and how the tax laws might benefit you. Your first 30-minute visit is free to let you sample what we can do for you at no cost or obligation. We also invite you to submit questions you'd like to have answered in a future article!

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