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September 2004 - Tax Savings for You In the New October 2004 Law (Part 1)

President Bush has recently signed “The Working Families Tax Relief Act of 2004” into law after it was overwhelmingly approved by both parties in both houses of Congress. Its primary features include:

- Continues beyond 2004-05 several family tax benefits that were due to expire, including the \$1,000 child tax credit and marriage penalty relief.
- Creates one definition of “child” for dependency exemption rules, head of household filing status, the dependent care credit, the child tax credit, and the earned income credit. In the past, each of these have had different, conflicting definitions to deal with.
- Combat pay is now included in earned income for several purposes.
- Extended several other tax benefits, including the educators’ expense deduction, availability of medical savings accounts, and the qualified electric vehicle credit.

This latest tax law revision deals with many other areas as well. Almost everyone will be affected, so I’ll try to make this as easy to understand as possible. Please get professional help if you have questions on how you should respond to these tax law changes.

Child Tax Credit Changes

The child tax credit had already been increased to \$1,000 for 2003 and 2004, and was scheduled to drop back to \$700 beginning in 2005. The new law extends the \$1,000 child tax credit through 2010 (after which it is currently scheduled to drop back to \$500).

The “refundable” feature of the child tax credit has also been expanded in this new law. Most tax credits are only effective until they reduce your income tax to zero. A refundable credit will give you a limited amount of credit, even if your income tax is zero, meaning you can get a tax refund even when no tax was paid. Previous law allowed the credit to be refundable in the amount of 10% of the amount of your taxable earned income above \$10,750. The new law increases this to 15%. **For families with earned income of \$20,750, this change means you may qualify for an additional refund of up to \$500. At \$30,750, the change could mean an additional \$1000 refund for you.** You may wish to check where you are on earned income so far this year, and plan accordingly through year end to get as much of this new additional refund as possible.

Marriage Penalty Relief

Tax returns filed for 2003 allowed married couples with taxable income of up to \$56,000 to have the same tax as if each spouse were single. Previously these married couples paid up to \$1,000 in additional tax, simply because they were married. Previous law would have ended this marriage penalty relief for 2004. **The 2004 Tax Law extends this marriage penalty relief through 2007.**

Larger 10-Percent Tax Bracket Continued

In 2004, the first \$7,150 of taxable income for singles and \$14,300 for married taxpayers filing jointly is taxed at 10%. Prior law was scheduled to reduce these amounts to \$6,000 for singles and \$12,000 for married couples in 2005, which would have increased taxes for most singles by \$57.50 and for most married couples by \$115.00. The new law keeps the higher levels and also indexes them for inflation each year through 2010.

Alternative Minimum Tax (AMT) Relief Continued

AMT is designed to make certain that “high income” taxpayers with large deductions pay tax. It is a very complex tax that works differently for each person. Its effect is to make deductions like state income tax, property tax, and employee business expenses ineffective beyond a certain maximum level, after which taxes of 26 to 28 percent apply. With inflation and tax law changes, more and more average income taxpayers are getting caught by this tax. Previous law provided a little relief by increasing the amount of income exempt from this tax from \$45,000 to \$58,000, but it was scheduled to expire at the end of 2004. The new 2004 tax law continues this benefit for one more year, until the end of 2005.

Military Tax Reduction

Past law excluded military combat pay from earned income, used to calculate the refundable portion of the child tax credit discussed earlier in this article. **The new 2004 tax law allows combat pay to be included in the calculation of refundable tax credit, effective for tax returns filed this year and for 2005, a sizeable benefit for many military families.** Care will be needed in applying this election, since in some cases it will be a benefit and in others it will cause a tax increase. Be sure to ask for qualified help in applying this new provision if you have any questions about it.

Educators' Expense Deduction

In 2002 and 2003, a deduction of up to \$250 was allowed for kindergarten through grade 12 educators. It expired at the end of 2003. **The new 2004 tax law extends the educators' expense deduction for two more years, through the end of 2005.**

Electric Vehicle Credit

Current law allowed for a 10% tax credit through 2003, up to a maximum credit of \$4,000, for the purchase of a motor vehicle powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electric current. This credit was scheduled to be phased out beginning in 2004. The new 2004 tax law continues the full credit for 2004 and 2005.

Other Provisions

There is more to this new tax law than can be covered in a single article. The discussion of the new definition of a child is complex enough it will require an article all of its own. There are also business provisions to the new law which will be covered in this series. Be sure to read these follow-up articles as well, they will save you money!