1998

Chart Your Course : Planning For the 1998 Tax Season; A CPA's Guide for Taxpayers

American Institute of Certified Public Accountants (AICPA)

1998 TAX RATES

Single

If Taxable Income Is:	The Tax Is:
Not over $25,350	15% of the taxable income
Over $25,350 but not over $61,400	$3,802.50 plus 28% of the excess over $25,350
Over $61,400 but not over $128,100	$13,896.50 plus 31% of the excess over $61,400
Over $128,100 but not over $278,450	$34,573.50 plus 36% of the excess over $128,100
Over $278,450	$88,699.50 plus 39.6% of the excess over $278,450

Married Individuals Filing Joint Returns and Surviving Spouses

If Taxable Income Is:	The Tax Is:
Not over $42,350	15% of the taxable income
Over $42,350 but not over $102,300	$6,352.50 plus 28% of the excess over $42,350
Over $102,300 but not over $155,950	$23,138.50 plus 31% of the excess over $102,300
Over $155,950 but not over $278,450	$39,770 plus 36% of the excess over $155,950
Over $278,450	$83,870 plus 39.6% of the excess over $278,450

Head of Households

If Taxable Income Is:	The Tax Is:
Not over $33,950	15% of the taxable income
Over $33,950 but not over $87,700	$5,092.50 plus 28% of the excess over $33,950
Over $87,700 but not over $142,000	$20,142.50 plus 31% of the excess over $87,700
Over $142,000 but not over $278,450	$36,975.50 plus 36% of the excess over $142,000
Over $278,450	$86,097.50 plus 39.6% of the excess over $278,450

Married Filing Separately

If Taxable Income Is:	The Tax Is:
Not over $21,175	15% of the taxable income
Over $21,175 but not over $51,150	$3,176.25 plus 28% of the excess over $21,175
Over $51,150 but not over $77,975	$11,569.25 plus 31% of the excess over $51,150
Over $77,975 but not over $139,225	$19,885 plus 36% of the excess over $77,975
Over $139,225	$41,935 plus 39.6% of the excess over $139,225

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The information in this brochure is for general purposes and is not intended as specific advice for any individual business. In addition, late-breaking tax developments may alter certain tax-planning strategies. Before acting on any advice, consult a CPA.

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INTRODUCTION

Tax planning and preparation for your yearly tax bill is like preparing for a trip; the temptation is to let it all go to the last minute, hoping it will all come together in the end. But, like a good vacation, a hassle-free tax season requires you to do some work ahead of time. Planning allows you to get every tax advantage to which you're entitled, and not lose out because you missed something in the rush of tax season. Below you'll find basic tax information as well as tax-trimming tips to help you map out your 1998 taxes and sail smoothly through tax season.

THIS YEAR'S BASICS

Standard Deductions

Standard deductions have been adjusted upward from 1997 levels to the following:

- Single — $4,250.
- Married filing jointly — $7,100.
- Head of household — $6,250.
- Married filing separately — $3,550.

People age 65 or older, or who are blind, may claim an additional deduction (for each condition) of $850 if married (filing jointly or separately) or $1,050 if single or filing as head of household. Keep in mind that you'll only claim the standard deduction if you don't have sufficient itemized deductions.

For each individual claimed as a dependent, where the dependent has earned income for the year, the standard deduction is the greater of $700 or $250 plus the earned income amount.

Exemptions

Each personal exemption in 1998 is worth $2,700, up $50 from 1997. You may claim an exemption for any dependent relative, whether a child or a parent, as long as you provide more than half of the support for the relative, and all other conditions are met.

Exemption Phase-Out

The income levels (adjusted gross income, or AGI) at which exemptions begin to be phased out for 1998 are as follows:

	Begins after AGI of	Ends after AGI of
Single	$124,500	$247,000
Married filing jointly	$186,800	$309,300
Head of household	$115,650	$278,150
Married filing separately	$ 93,400	$154,650

Exemptions are cut 2% for each $2,500 or fraction thereof above AGI levels listed in the left column, and are lost entirely after AGI levels in the right column are surpassed.

A DOZEN WAYS TO SAVE ON YOUR 1998 TAX BILL

Maximize a 401(k). If your employer offers a 401(k), consider making the maximum contribution, which is $10,000 for 1998. Your contribution lowers your gross income, and your earnings grow, tax-deferred, until retirement.

Reevaluate IRAs. Plan to make maximum contributions to your Individual Retirement Account (IRA). Even if you cannot deduct your contributions, IRAs still make tax sense since earnings grow, tax-deferred, until withdrawn.

Transfer Lump Sums. If you expect a lump-sum distribution from a pension or profit-sharing plan and don't have an immediate need for the money, consider rolling it over to an IRA, where it will continue to grow, tax-deferred. Be sure the transfer is made directly from one trustee to another. Otherwise, 20% must be withheld for the IRS. In addition, the distribution must be rolled over within 60 days to continue the tax deferral.

Open a Keogh. Keoghs are available to individuals with any amount of self-employment income. Generally, if you qualify, you can contribute to a defined contribution plan and deduct your contribution between 15-25% of your net self-employment income (depending on the type of plan), but subject to a maximum of $30,000.

Adjust Withholding. Before the end of the year, match your withholding to your estimated tax liability. If you've moved up to a higher tax bracket, adjust your withholding or you may be hit with an underpayment penalty. Conversely, you may be giving the IRS more than you need to; if you received a tax refund last year, you may want to adjust your withholding, and invest the extra cash.

Shift Income. To reduce your family's overall tax bill, consider transferring assets to your child — the income generated from these assets will be taxed at the child's lower rate. However, watch out for the "kiddie tax." If your child is under the age 14 and has more than $1,300 in unearned income, the excess will be taxed at your highest marginal rate. For children age 14 and over, unearned income is taxed at their own rate. (Earned income, such as wages, is always taxed at the child's rate.)

Give Gifts. To minimize the tax burden for your heirs, consider a gift-giving plan. You and your spouse each can give up to $10,000 a year to as many recipients as you wish with no gift tax.

Donate to Charity. As long as you itemize, charitable donations are generally fully deductible up to 50% of your AGI. However, the rules require written documentation for any donation of $250 or more, and for donations of $75 or more where you receive something in exchange. For those who donate appreciated securities, a double tax break is available. Generally, if you have held the securities long-term, you can deduct the property's fair market value up to 30% of your AGI, *and* not pay tax on its appreciation. Donating your time and energies to a charity? Certain expenses you incur for charity work are deductible, but documentation is required.

Tally Medical Bills. Only medical expenses that surpass 7.5% of your AGI are deductible, so total them before year-end to see if you are close to the deductibility limit. If you are, it may be worthwhile to accelerate your upcoming medical appointments and expenses. Otherwise, you may want to postpone non-essential medical procedures until next year. When calculating your deduction, don't forget to include expenses such as transportation to and from medical facilities, and medical supplies.

Bunch Miscellaneous Deductions. Miscellaneous deductions generally fall into one of three categories: unreimbursed employee business expenses, investment expenses, and tax-related expenses. These expenses are deductible only if they are above 2% of your AGI. If your miscellaneous expenses hover around the 2% limit, try to bunch them into alternate years to increase your deduction.

Use Your Home to Your Advantage. You can deduct your mortgage interest, points paid to secure a mortgage on a principal residence, and property taxes. But, for a refinanced mortgage, generally the sum of any points paid must be ratably deducted each year over the term of the loan. If you have debt on credit cards charging high interest rates, consider a home equity loan. Interest rates are generally lower, and interest payments are generally tax deductible.

Watch Out for the AMT. If you have an abundance of credits and deductions this year, you may be subject to the alternative minimum tax (AMT), a separate tax system designed to ensure that everyone pays a minimum amount of tax. The only way to know for sure is to calculate your taxes both ways.

NEW TAX LAWS IN 1998

Capital Gains Holding Period Decreased. For noncorporate taxpayers, new legislation in 1998 reduced the holding period needed for assets to qualify for long-term capital gains treatment. In 1997, the holding period was increased to more than 18 months, but the 1998 legislation decreases it once again to more than 12 months. In addition, the new law made the 12-month holding period *retroactive* to January 1, 1998.

Child Tax Credit. For 1998, there is a new $400 child tax credit ($500 in 1999 and later years) for each qualifying child of a taxpayer. A qualifying child must be a citizen, under 17, an individual for whom the taxpayer can claim a dependency exemption, and must be a son, daughter, or direct descendant of the taxpayer, or a stepson, step-daughter, or eligible foster child of the taxpayer. The credit gets reduced by $50 for each $1,000 of modified AGI over a certain threshold. For married taxpayers filing joint returns, the threshold is $110,000; for taxpayers filing single or head of household returns, it is $75,000; and for married taxpayers filing separate returns, it is $55,000.

Health Deduction for Self-Employeds. The cost of health insurance for self-employed individuals will become 100% deductible over the next several years. In 1998, the deduction will be 45%, and eventually reach 100% in the year 2007.

Roth IRAs. This new type of IRA allows taxpayers to put money away, and although the contributions can't be deducted, any earnings on the account are tax-free. The money is not taxed when withdrawn, as long as the withdrawal is made more than 5 years after the IRA has been established and is made on or after age 59 1/2, or on or after death or disability, or for first-time home buyer expenses (up to $10,000). This IRA's availability starts phasing out for individuals with AGI over $95,000 and for married couples with AGI over $150,000. Individuals with AGI of $100,000 or less may convert a regular IRA to a Roth IRA at any time, with the amount converted includable in income in the year of the conversion. However, a special rule allows taxpayers to roll over a regular IRA to a Roth IRA in 1998, and have the amount included in income spread over 4 years. Or, an individual can elect out of the 4-year spread, and have the entire distribution included in income in 1998. If a taxpayer does not elect out, then the 4-year ratable inclusion rule will automatically apply.

Penalty-free Withdrawals for All IRAs. Beginning in 1998, penalty-free withdrawals from any type of IRA will be allowed for first-time homebuyer expenses (up to $10,000) and higher education expenses.

HIGHER EDUCATION CREDITS

Lifetime Learning Credit. Individual taxpayers are allowed to claim this credit against federal income taxes equal to 20% of qualified tuition and fees paid during the tax year on behalf of the taxpayer, the taxpayer's spouse, or a dependent. The maximum credit is $1,000 per year, per taxpayer. The student must be enrolled at an eligible education institution. The student is eligible for the credit so long as he or she is taking undergraduate or graduate level classes to acquire or improve job skills, at an eligible institution. This credit is computed on a per taxpayer return basis, so it doesn't vary based on the number of students in a taxpayer's family, and it may be claimed for an unlimited number of tax years. This credit phases out for single taxpayers with modified AGI between $40,000–$50,000, and $80,000–$100,000 for joint returns. The Lifetime Learning Credit is available for expenses paid after June 30, 1998, for academic periods beginning after that date.

Hope Scholarship Credit. Individual taxpayers are allowed to claim a nonrefundable credit against federal income taxes, up to $1,500 per student, per year, for qualified tuition and fees paid during the year on behalf of a student; a student can be the taxpayer, the taxpayer's spouse, or a dependent, and must be enrolled in a post secondary degree or certificate program at an eligible institution, on at least a half-time basis. The credit is computed per student, for each eligible student in the taxpayer's family for the first two years of undergraduate education. This credit phases out for taxpayers filing singly with modified AGI between $40,000 and $50,000, and $80,000 and $100,000 for joint returns. The Hope credit is available for expenses paid after December 31, 1997, for academic periods starting after that date.

Education IRAs. As of January 1, 1998, taxpayers can establish education IRAs. These IRAs must be created exclusively to pay the qualified higher education expenses of a named beneficiary, such as a child or grandchild. Generally, the earnings on the funds in the IRA won't be taxed until a distribution from the IRA is made, and distributions from the IRA won't be included in gross income. But, the annual contribution can't be more than $500 per beneficiary, and can't be made after the beneficiary reaches 18. And, you can't contribute to an education IRA in the same year in which you contribute to a qualified state tuition program on behalf of the same beneficiary. Eligibility for education IRAs phases out for single taxpayers with modified AGI between $95,000–$110,000, and between $150,000–$160,000 for joint returns.

Note: Of the three methods above, you can only elect one for each student in any given year.

Here to Serve You. To make sure you're taking full advantage of the tax laws, talk to a CPA. CPAs are well-versed in the latest tax developments and planning strategies that can help you minimize your tax burden.