1994

21 Money-Saving Tax Tips: A CPA's Guide to Year-End Tax Planning

American Institute of Certified Public Accountants. Communications Division

1994 tax rates

Single

If taxable income is...	The tax you owe is...
$0 - $22,750	15% of taxable income
$22,751 - $55,100	$3,412.50 + 28% of the amount over $22,750
$55,101 - $115,000	$12,470.50 + 31% of the amount over $55,100
$115,001 - $250,000	$31,039.50 + 36% of the amount over $115,000
$250,001 or more	$79,639.50 + 39.6% of the amount over $250,000

Joint Surviving Spouses

$0 - $38,000	15% of taxable income
$38,001 - $91,850	$5,700 + 28% of the amount over $38,000
$91,851 - $140,000	$20,778 + 31% of the amount over $91,850
$140,001 - $250,000	$35,704.50 + 36% of the amount over $140,000
$250,001 or more	$75,304.50 + 39.6% of the amount over $250,000

Married, Filing Separately

$0 - $19,000	15% of taxable income
$19,001 - $45,925	$2,850 + 28% of the amount over $19,000
$45,926 - $70,000	$10,389 + 31% of the amount over $45,925
$70,001 - $125,000	$17,852.25 + 36% of the amount over $70,000
$125,001 or more	$37,652.25 + 39.6% of the amount over $125,000

Head of Household

$0 - $30,500	15% of taxable income
$30,501 - $78,700	$4,575 + 28% of the amount over $30,500
$78,701 - $127,500	$18,071 + 31% of the amount over $78,700
$127,501 - $250,000	$33,199 + 36% of the amount over $127,500
$250,001 or more	$77,299 + 39.6% of the amount over $250,000

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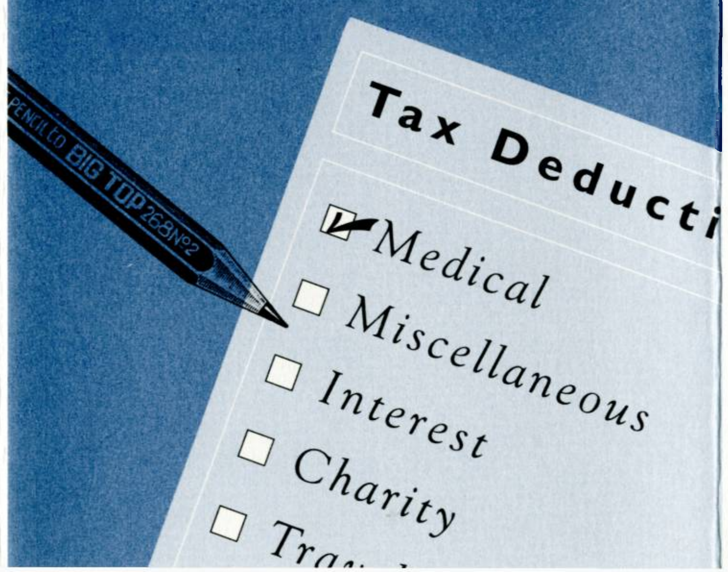

Prepare for 1994 Tax Changes

This tax year may be a difficult one for some individuals. The Revenue Reconciliation Act of 1993 retroactively changed some tax laws to the beginning of last year. However, even more of its provisions take effect for 1994. To help you get up to speed on these tax law developments and to plan a course of action for dealing with them, this brochure lists the tax law changes and 21 strategies that you can use to lower your 1994 tax bill.

Planning Your Attack

Aggressive tax planning requires strategy. For many people, the classic tactic of accelerating deductions and deferring income is most effective. By drawing tax-deductible expenses into 1994 and postponing income to 1995, you lower your tax bill this year and gain the use of your money for an extra 12 months.

However, if you expect to be subject to a higher tax bracket in 1995, you may want to take the opposite approach — accelerate income and defer deductions. Income accelerated into this year will be taxed at your lower 1994 rate, while any deductions you can postpone will be more valuable to you next year.

In either case, choose your tax-planning approach well before year-end and keep your eyes open for opportunities to implement it. For example, controlling income can be accomplished by timing the sales of profitable investments or asking your employer to delay a year-end bonus. You can accelerate deductions by paying your state taxes in December instead of January. Deferring deductions can be accomplished by postponing an optional medical procedure until after year end.

New in 1994

Social Security. Social Security recipients with total incomes over $34,000 for singles, or $44,000 for married couples, will have up to 85 percent of their benefits taxed by the federal government in 1994, up from 50 percent.

Medicare Payroll Tax. Previously, the Medicare payroll tax of 1.45 percent (2.9 percent for the self-employed) was applied only to the first $135,000 of earnings. However, this ceiling has been eliminated, meaning all wages are now subject to the tax.

Earned Income Tax Credit. The maximum credit has been increased to $2,038 for a taxpayer caring for one child, and $2,527 for a taxpayer caring for two or more children. The new tax bill also extended the credit to some low-income individuals without children. The maximum credit for childless workers is $306 in 1994.

Seller-Paid Points. The IRS announced this year that it will allow home buyers to deduct points on a mortgage even if they were paid by the seller. Previously, the buyer was unable to deduct seller-paid points. This provision is retroactive to January 1, 1991. If you missed out on this tax break sometime between 1991 and 1993, you will need to file an amended return for that year.

Business Expenses. The business meal and entertainment expense deduction was reduced from 80 percent to 50 percent of otherwise allowable costs. Also, the deduction for club dues was eliminated.

Inflation Adjustments

Standard Deductions. The standard deductions have risen this year to the following levels:
$3,800 — single
$6,350 — married, filing jointly
$5,600 — head of household
$3,175 — married, filing separately

Exemptions. Each exemption you claim in 1994 is worth $2,450, up $100 from last year. However, exemptions are phased out after your income reaches certain levels. The 1994 income limits are listed below:
$111,800 — single
$167,700 — married, filing jointly
$139,750 — head of household
$83,850 — married, filing separately

For every $2,500 (or fraction thereof) by which adjusted gross income (AGI) exceeds these amounts, you must reduce your exemptions by 2 percent.

Itemized Deduction Phaseout. The income limit for the itemized deduction phaseout has also risen this year. All taxpayers with AGIs above $111,800 ($55,900 if married, filing separately) must reduce itemized deductions by 3 percent of the amount by which AGI exceeds this limit.

tax tips

Maximize a 401(k). A 401(k) plan remains one of the best tax shelters around. Your contribution lowers your taxable income, and your earnings grow tax-deferred until retirement. If your employer offers a 401(k), consider making the maximum contribution, which is $9,240 for 1994.

Reevaluate IRAs. Individual Retirement Accounts (IRAs) have fallen out of favor with some people since the rules on deducting contributions were tightened. But many people can still deduct their IRA contributions. Those who are not covered by an employer-sponsored pension plan can take a full deduction for a contribution of up to $2,000. Anyone who is covered by a pension may still be able to take the deduction, depending on income. Married couples with AGIs of less than $50,000, and singles with AGIs of less than $35,000, qualify for a full or partial deduction. Even if you cannot deduct your contributions, IRAs still may make tax sense since earnings grow tax-deferred until withdrawal.

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, roll it over to an IRA account so it will continue to grow tax-deferred. But be sure the transfer is made directly from one trustee to another. Otherwise, the plan administrator will be required to withhold 20 percent for the IRS.

Open a Keogh. Keoghs are available to individuals with any amount of self-employment income. Generally, if you qualify, you can contribute and deduct up to 25 percent of your net self-employment income, or $30,000, whichever is less.

Find A Safe Harbor. If you are required to pay estimated taxes, a provision in last year's tax bill will simplify the process beginning this year. Generally, you must pay 90 percent of your current year's tax bill through estimated payments or face penalties. However, a safe harbor has been restored allowing you to base your estimated payments on the prior year's taxes. You may pay 100 percent of your prior year's taxes if your AGI was less than $150,000, or 110 percent if your AGI was more than $150,000.

Invest Tax-Free. Tax-free municipal bonds should be part of your investment portfolio. Bonds issued in the state in which you live are usually tax-free. Keep in mind, a tax-free bond yielding 4 percent is equal to a taxable investment yielding 6.3 percent in the 36-percent tax bracket.

Use Series EE Bonds. Consider investing in Series EE bonds if you are saving for your child's college education. Income from bonds may be totally tax-free if they are used to pay college tuition for your children. Income limits apply to this tax break so be sure to consult a tax adviser.

Favor Capital Gains. The difference between the long-term capital gains tax rate and the highest tax bracket on regular income has risen to over 11 percent. This disparity in rates makes capital gains income more attractive than dividend or interest income to many people in the upper tax brackets. However, keep in mind that taxes are only one consideration in choosing investments. Be sure to get professional advice.

Look Into Small-Business Stock. Congress has made it worth your while to look into small-company stock by establishing a 50-percent capital gains exclusion for their proceeds. To qualify, the stock's original issuance must have been after August 10, 1993, and you must hold it at least five years. Restrictions apply on the types of businesses that qualify, so be sure to get professional advice before your purchase.

Shift Income. To reduce your family's overall tax bill, you may want to consider transferring assets to your child — that way, the income generated will be taxed at the child's lower rate. However, beware of the kiddie tax. If a child under age 14 has more than $1,200 in unearned income, the excess will be taxed at your highest marginal tax rate. All income of children 14 or over is taxed at their own tax rate.

Give Gifts of Cash. Last year's tax bill raised the top estate tax from 50 to 55 percent. To remove money from your estate and minimize the tax burden for your heirs, consider beginning a gift-giving plan. You can give up to $10,000 a year to as many recipients as you wish without gift tax consequences. The limit is $20,000 if your spouse joins you in making the gift.

Hire Your Child. If you own a business, consider hiring your child as an employee. Your child can earn income and you can take a deduction for the salary. Just be sure your child does a real job at a fair salary.

Act Charitably. As long as you itemize, charitable deductions remain fully deductible, up to 50 percent of your income. However, be aware that the IRS now requires written documentation for any donation of $250 or more. A cancelled check is no longer adequate proof.

Donate Appreciated Property. A double tax break is available for those who give appreciated property to charity. As long as you have held the property for more than one year, you can take a deduction for the property's fair market value and you don't have to pay tax on its appreciation.

Tally Your Medical Expenses. Since only medical expenses that surpass 7.5 percent of your AGI are deductible, be sure to total them before year-end to see if you are near the limit. If you are, accelerate elective medical procedures into this year to increase your deduction. Otherwise, postpone any non-essential medical expenses until next year. When making your calculation, don't forget to include doctor bills, prescriptions, insurance premiums, and transportation costs to and from medical facilities. Many other expenses qualify, such as acupuncture, psychotherapy and braces, so remember to include them in your total.

Bunch Miscellaneous Expenses. Miscellaneous expenses are deductible only to the extent that they surpass 2 percent of your AGI. Expenses that qualify as miscellaneous generally fall into one of three categories: employment or business, investment, or tax. If your miscellaneous expenses are near the 2-percent limit, try to bunch them into alternate years to increase your deduction.

Take Advantage of Your Home. A home remains one of your best tax shelters. You can deduct your mortgage interest, points paid to secure a mortgage and property taxes. Keep in mind, however, the points paid on refinanced mortgages are usually not deductible immediately. Instead, you must deduct this sum equally each year over the term of the loan.

Write Off Moving Expenses. For a work-related move, you can deduct the cost of transporting you, your family and your belongings from your former residence to your new home. However, beginning this year, the cost of meals while traveling, temporary lodgings, and house-hunting expenses are no longer deductible.

Borrow Smart. Consider trading high-interest, non-deductible credit card debt for a home equity loan. The interest rates are generally much lower and your interest payments are tax-deductible.

Beware of 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 if the AMT affects you is to figure your taxes both ways.

Consult A CPA. To make sure you are not paying more in taxes than you should, talk to a CPA. CPAs are well-versed on the latest tax developments and planning strategies that can help you minimize your tax burden.