

## 4-Serenity Tax News

Fall 2002 Edition for Individual Taxpayers

### **Are You Having Enough Tax Withheld From Your Wages?**

*Changes in the tax law could leave you short at the end of the year*

If you've noticed an increase in your take-home pay, and you didn't receive a raise, it is because the tax charts your employer uses to figure your withholding have changed. Tax changes included in the Economic Growth Act of 2001 resulted in a reduction in the tax rates, and the addition of a new 10% tax bracket. These reductions result in lower amounts of federal income taxes withheld from your paycheck. At the end of the year, your tax will be lower, but so will your withholding.

But let's look at reality and when it can hurt. The 10% tax bracket applies to the first \$6,000 for a single taxpayer and \$12,000 for a married couple filing a joint return. The withholding tables, effective January 1, 2002, were adjusted to reflect the tax rate changes. Therefore, a taxpayer who is claiming single on his/her Form W-4 will have approximately \$300 less federal income tax withholding during the year compared to 2001.

Single taxpayers who have little change in their income will generally notice little change in the amount of refund they receive at the end of the year. The

outcome is drastically different for married couples. A taxpayer who claims married on his/her Form W-4 will have approximately \$600 less federal income tax withheld during the year, compared to the 2001 withholding amounts. The potential for danger exists when both spouses each claim married on their Forms W-4.

Example: John is married and claims married on his Form W-4. John earns \$1,000 gross wages on a bi-weekly basis. He will have \$91 federal income tax withheld this year, compared to \$114 last year. This is \$23 less withholding per bi-weekly period. With 26 bi-weekly payroll periods in a year, he will have \$598 less federal income tax withheld, which almost matches the couples' \$600 decrease in tax due to the 10% tax bracket. John's wife Ellen also claims married on her Form W-4 and earns \$1,000 gross wages on a bi-weekly basis. Ellen will also have \$91 federal income tax withheld per pay period in 2002 resulting in \$598 less withholding from her paycheck for the year. Assume John and Ellen do not have children or any other income. Their income tax liability for 2001 was \$5,794 and their combined withholding was \$5,928, for a joint refund of about \$134. Their income tax liability for 2002 (based on the same earnings) will be about \$5,122 and their combined withholding will be \$4,732, resulting in a balance due for 2002 of \$390.

If you are expecting a refund, finding out you owe additional tax at the end of the year is an unwelcome surprise. You should make a point of having your withholding checked as soon as possible to make sure you are having sufficient amounts withheld to match your desired year-end result.

## **New Laws Increase Amounts That Can Be Contributed to IRAs**

*Saving for retirement can save you money*

The contribution limit for traditional IRAs increases to \$3,000 for 2002. This means that you may contribute \$1,000 more to an IRA than in the past. If you reach age 50 at any time during 2002, your contribution limit increases by an additional \$500.

Your traditional IRA contribution may be deductible if you meet certain requirements. For starters, you must have compensation. Compensation is payment for services in the form of a wage, salary, bonuses, etc. Your IRA contribution is limited to the lesser of 100% of your compensation or the annual limit. For 2002, this limit is \$3,000. Secondly, the rules change if you or your spouse are active participants in an employer provided retirement plan.

If you are single and you are not covered under a retirement plan provided by your employer, or you if you are self-employed, you can deduct your IRA contribution regardless of your income level. If you participate in an employer provided retirement plan, your deductible IRA contribution is reduced once your adjusted gross income reaches \$34,000. You are no longer permitted to make a deductible IRA contribution once your adjusted gross income reaches \$44,000.

The rules get a bit more complex if you are married and you file a joint return with your spouse. If neither you nor your spouse is covered under a retirement plan provided by your employer, your contributions to your IRA are deductible. Each of you may contribute and deduct

the maximum amount of \$3,000 to your IRA provided at least one of you has at least \$6,000 in compensation. If both of you are covered by an employer provided retirement plan, your deductible IRA contributions are limited once your adjusted gross income reaches \$54,000. Neither of you may make a deductible IRA contribution once your adjusted gross income reaches \$64,000.

Now for the complex part of these rules. If only one of you, either you or your spouse, is an active participant in an employer provided retirement plan, the nonactive spouse can make a deductible IRA contribution if your combined adjusted gross income is less than \$150,000. Once your combined adjusted gross income reaches \$160,000, your IRA contribution is no longer deductible. For the spouse who is an active participant, the contribution is only deductible if the combined adjusted gross income is less than \$54,000, and no longer deductible once the combined adjusted gross income reaches \$64,000.

If you find that you are unable to deduct your IRA contribution because your adjusted gross income exceeds the limits, you might wish to consider contributing your money to a Roth IRA. Contributions to a Roth IRA are never deductible. However, the contributions grow tax-free and distributions are not included in taxable income provided they remain in the account for five years or you meet other exceptions. Not everyone can make contributions to a Roth IRA. If you are single, your contributions are limited once your adjusted gross income reaches \$95,000, and no longer allowed once your adjusted gross income reaches \$110,000. These limits are \$150,000 and \$160,000 respectively if you are filing a joint return.

## Are You Expecting the Birth of a Child?

*Expect some tax breaks as well*

If you have a baby in 2002, you may discover that you are entitled to a few tax breaks. The most obvious is that you are entitled to a dependency exemption for your child, provided you obtain a Social Security number as soon after the birth as possible and before you file your tax return. To apply for a Social Security number, file form SS-5 with the Social Security Administration. Some hospitals will assist you with this form before you take your baby home. You are entitled to a dependency exemption regardless of the date during the year that the baby was born. You must also provide over half the child's support.

If you're married and you live with your spouse, generally the most advantageous filing status is married filing joint. But if you're unmarried, or if you did not live with your spouse at any time during the last half of the year, you may be eligible to use the head of household status.

If your child is a U.S. citizen or resident and you can claim the child as a dependent, you will be eligible to claim a \$600 per child tax credit. This credit is available regardless of your filing status. The credit generally cannot reduce your tax below zero, but may be refundable up to the total amount of the credit allowed if your taxable earned income exceeds \$10,000. You may also be eligible for the earned income tax credit. The earned income tax credit is available to workers with low income.

Don't forget daycare expenses. When you pay someone to care for your child while you work or look for work, you may be entitled to a credit for your qualified childcare expenses. This credit

allows you to receive a credit of up to 30 percent of your expenses depending on your income level. If you are married, both you and your spouse must work, and you must file a joint return.

## Saving for Your Child's College Education

*New tax breaks make saving easier*

You are permitted to contribute up to \$2,000 to a **Coverdell Education Savings Account** (formerly called an Education IRA). This is an increase from the \$500 that was allowed in prior years. You can contribute up to \$2,000 for each beneficiary, provided your adjusted gross income is less than \$95,000 (\$190,000 if you file a joint return). Contributions must be made on or before the date the beneficiary turns age 18 and must be distributed, along with the earnings, before the beneficiary reaches age 30. Any unused balance may be rolled into another beneficiary's account.

A **qualified state tuition savings plan**, or **§529 plan** is another way to save for college. Contributions to the plan earn tax-free money, and contributions can be much higher than a Coverdell Education Savings Account. Generally, you can contribute up to \$11,000 per beneficiary to a §529 plan. The contributions are considered a gift to the beneficiary. If you elect, you may contribute \$55,000 all at once and treat the contribution as if it were made over a five-year period, still escaping any gift tax consequences. Distributions from a qualified state tuition plan are tax-free provided they are used to pay qualified higher education expenses.

**Georgia's 529 College Plan** (Visit: [www.gacollegesavings.com](http://www.gacollegesavings.com))

*Georgia Tax Deduction* - The amount you contribute may be deductible from

your Georgia taxable income up to a maximum of \$2,000 a year per beneficiary. The State tax deduction is available to you every year, but contributions must be made by April 15 to receive the preceding year's deduction. This is the only 529 program to offer a state tax deduction to Georgia residents.

*Tax-Free Withdrawals* - Contributions to the Georgia Higher Education Savings Plan grow free from federal and state income tax. Through the power of compounding, the money you save in a tax-deferred account can provide greater potential for growth. And withdrawals used for qualified expenses will be free of both federal and Georgia income tax.

## Quik Tips

1. In 2002, you can gift up to \$11,000 to any number of individuals without incurring a gift tax liability.
2. For 2002, you are allowed to defer up to \$11,000 into your §401(k), §457, or §403(b) plan with your employer.
3. If you turn age 70 on July 1, 2002 or later, you are not required to begin your minimum required distributions from your IRA until April 1, 2004. You are not considered to be age 70½ until January 1, 2003. Minimum required distributions from your IRA must begin no later than April 1 of the year following the year you reach age 70½.
4. Do your dependents have summer jobs? Each can earn up to \$4,700 during the year without incurring an income tax liability and you can still claim them as a dependent come tax time.
5. Expenses you pay to send your child to an overnight summer camp generally do not qualify as a childcare expense eligible for the child and dependent care credit.
6. If you purchased a new home this year and paid points, you may be able to

deduct them on your tax return. Points are certain charges paid for obtaining a home mortgage.

7. If you adopted a child in 2002 and paid qualifying adoption expenses, you may be entitled to a tax credit of up to \$10,000.
8. Foster children no longer need to live with you for the entire year to qualify you for the earned income tax credit. As long as the foster child lives with you for more than half the year, he or she may be a qualifying child for the credit.
9. Beginning in 2002, the deduction for student loan interest is no longer limited to the first 60 months of the repayment period.
10. If you are disposing of real estate or other business property for a gain, you may want to consider a **like-kind exchange**. This would defer the gain of the property disposed of into the acquired property. Generally the replacement property must be identified within 45 days of the sale, and the replacement property must be acquired within 180 days. You must use a 'qualified intermediary' to complete the exchange. Contact me ahead of time and I can direct you to a qualified intermediary and consult you on various ways to reduce or defer your tax bill.

Remember that smart tax planning begins before December 31<sup>st</sup>! Please call for more information, or to set up an appointment for a detailed tax plan.

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