

## **2002 Tax Reform Bill Seminar**

(Appendix 2)

A two hour seminar was given to increase awareness all accounting changes for the firm's partners and staff that resulted in the 2002 bill reformation to reduce errors to increase processing time and to be knowledgeable to our clients when such questions arise. A participant's guide also follows the presenter's notes.

# 2002 Tax Update Seminar

(Presenter notes)

## Introduction

- Several key important congressional acts have been legislated
  - Job Creation and Worker Assistance Act of 2002
  - Trace Act of 2002
  - Clergy Housing Clarification Act of 2002
  - Expiring Tax breaks

## Where are we going with this?

- Job Creation Worker Assistant Act:
  - Extended unemployment benefits for an additional 13 weeks
  - Allows an additional 30% first-year depreciation deduction for eligible property
  - Extends Net Operating Loss carry back period to five years for 2001 and 2002
  - Creates an above the line deduction for qualifying expenses incurred by educators for classroom materials
  - Expands the exclusion for qualified foster care payments
  - Extends the availability of Archer Medical Savings Accounts through December 31, 2003
  - Limits the nonaccrual experience method of accounting for amounts received for the performance of qualified services and certain small businesses (health, law, engineering, architecture, accounting, actuarial science, performing arts or consulting – or services provided by certain small businesses – if you have a lot of nonaccrual items to take place for small business, research for limitations)
- Trade Act of 2002:
  - Refundable credit for health insurance cost of qualified workers who are dislocated from their employment by foreign trade (equal to 65% of the premiums paid by eligible tax payers (TAA (Trace Adjustment Assistance) recipients, alternate TAA recipients, Pension Board Guaranty Corporation (PBGC)) for qualified costs by them and their families; form 8887 will be mailed to the tax payer: premiums paid by taxpayers for coverage under normal insurance plans (no flexible spending plans) such as COBRA, and other state required coverage are to be taken into account in determining the health insurance deduction
- Clergy Housing Clarification Act of 2002:
  - Housing allowance exclusion is officially limited to the fair **rental** value of the housing (including furnishing and utility costs) – personal insight note: have the house appraised and signed off and you will stay out of trouble if any dispute or high risk of IRS investigation happens
- Expiring Tax Breaks that have been extended from December 2002 to December 2003:
  - Nonrefundable personal tax credits offset allowed against both regular and AMT
  - Work opportunity credit
  - Welfare-to-work credit
  - Credit for electricity production from wind, closed-loop biomass and poultry waste
  - Limitation on percentage depletion for oil and gas from marginal wells
  - Zone academy bond limitations – certain educational bonds issued between 1998 and 2003 limited to a national basis of distribution
  - Deferral of the phase-out of the credit for the purchase of qualified electric vehicles
  - No extensions on exercise tax credit on luxury automobiles set to expire December 31, 2002 and research and experimentation tax credit scheduled to expire June 30, 2004

## Individuals

- Tax rates and deductions:
  - Tax table changes; income levels have increased for return filers to report interest and dividends to \$1,500 for Schedule B reporting purposes
  - FICA and self-employment tax purpose wage base \$84,900 for 2002
  - Itemized deduction income reduction phase-out increases by 3% of your 2002 adjusted gross income over \$137,700 (S), \$68,650 (M)
  - Standard Deduction increase \$4,700 (S), \$6,900 (H), \$3,925 (MFS), \$7,850 (MFJ)
  - Personal Exemption increase to \$3,000
  - Personal tax credits for nonrefundable personal tax credits, such as the child tax credit, dependent care credit, and the education credits, can reduce alternative minimum tax (AMT) as well as regular income on 2002 returns
  - Kiddy tax \$1,500
  - Child tax credit \$600
  - Nanny tax wage threshold \$1,300
  - Foreign Earned Income Exclusion is \$80,000 for 2002
  - Adoption Credit – the credit for non-special needs adoptions is made permanent and the maximum credit for all adoptions increases to \$10,000. The phase-out of the credit begins at MAGI of \$150,000 (instead of \$75,000) and is completely phased out at \$190,000
  - Earned Income Credit:
    - Maximum credit for eligible tax payers with no qualifying children with AGI less than \$11,060 (s), \$12,060 (MFJ) with no children; \$29,201 (S), \$30,201 (MFJ) with one child begins with a credit of \$376, with one child \$2,506, and with two or more \$4,140
- NOL's carry back – a five-year carry back period is allowed now for NOLs incurred in 2002 and 2001. the five-year period may be waived if it is more advantageous to use the regular carry back period
- Student-loan interest deduction up to \$2,500 may be deducted beginning with year 2002 with no 60 month limitation
- "Above-the-line" education expenses of up to \$250 per year for unreimbursed expenses in connection with books, supplies, computer equipment and supplementary materials in elementary and secondary education – no 2% AGI limitation for 2% rule
- Continuing care facility donations – the loan threshold for taxing imputed interest on entrance fees to qualified facilities is \$148,000 (up from \$144,000)
- Health reimbursement accounts:
  - Self-employed health insurance premiums deductible up to 70%
- Final ruling on new home sale exclusion rules – a \$250,000 – S (\$500,000 – MFJ) may be claimed repeatedly but usually only once every two years out of five principle residence (unforeseen circumstances do not effect the two year residency rule)
- New York Liberty Zone – Businesses located in the area on or south of Canal Street, and on or south of East Broadway and Grand Street where these intersect with Canal Street are eligible for special tax breaks such as increase in Work Opportunity Credit, increased first-year expensing limit of \$59,000, an addition first-year depreciation deduction of 30% is allowed for Liberty Zone property that does not qualify for the general 30% depreciation bonus
- Victims and Survivors of Terrorist Attacks – special tax breaks for the families of those killed in the September 11<sup>th</sup> attacks, anthrax attacks, and the Oklahoma City bombing include: income tax forgiveness, special estate tax rates, and tax free payments from various sources. Other survivors in area are also eligible for tax-free payments (September 11<sup>th</sup> Victim Compensation Fund of 2001, Qualifies disaster from employers, Death benefits from employers, Cancelled debts, Qualified payments to survivors of public safety officers)

- IRA Changes:
  - Traditional IRA and Roth IRA contribution limits – the maximum annual contribution for traditional and Roth IRAs increase to \$3,000; individuals age 50 and over can make an additional \$500 contribution, raising their maximum contribution limit for 2002 to \$3,500
  - Traditional IRA deduction phase out – deductions for active plan participants are phased-out if MAGI exceed \$34,000 if single or \$54,000 if married filing jointly (up from \$33,000 and \$53,000 respectively)
  - New life expectancy tables to compute IRA minimum distributions – final regulations for figuring required minimum distributions after age 70 ½ from traditional IRAs and issued revised life expectancy tables to be used for making the computation
  - IRS can waive 60-day rollover period – granted discretion to waive the 60-day deadline where illness, institutional error, or other events beyond taxpayer control result in the failure to complete a rollover within 60 days
  - Retirement savings credit – for 2002 to 2006, low-to-moderate income taxpayers may receive a tax credit for retirement contributions to traditional and Roth IRAs, and 401(k), 403(b), governmental 457, SIMPLE, or SEP plans; a credit of 10%, 20%, or 50% may be allowed for contributions up to \$2,000, depending on the income; the credit will not be available to joint filers with MAGI over \$50,000 heads of household with MAGI over \$37,500 and single persons, qualified widow(er)s, or married person filing separately with MAGI over \$25,000. Dependents, workers under age 18, and full-time students are also ineligible
  - Effective deferrals – The deferral limit for 401(K), 403(B), and SEP plans increase by \$500 to \$11,000 and the deferral limit for a governmental Section 457 plans increases from \$8,500 to \$11,000. The deferral limit for SIMPLE plans increase to \$7,000. For those age 50 and over, an additional \$1,000 deferral may be made if the plan allows the contribution – SIMPLE plan is \$500
  - Higher deductible contribution limits for SEP and Keogh plans – the maximum deductible contribution rate for profit-sharing plans increases from 15% to 25%. The compensation limit increases to \$200,000 and the dollar limit on contributions to \$40,000 assuming the plan is amended in 2002 to implement the increases
  - Expanded rollover options – eligible rollover distributions from a traditional IRA, qualified plan, 403(B) plan, or governmental Section 457 plan may be rollover to any of such plans. After tax contributions may also be rolled into a qualified contribution plan or traditional IRA
  - Faster vesting for matching contributions – for plan years beginning after 2001, plans must offer 100% vesting of employer matching funds in three years or must vest 20% per year starting in the second year of service
- Educational Changes:
  - Coverdell ESA contributions (educational IRA) – The annual contribution limit jumps from \$500 to \$2,000 per beneficiary. For married persons filing jointly, the contribution phase-out range increases to MAGI of \$190,000 - \$220,000, double the range for single filers. Contributions for 2002 can be made until April 15, 2003
  - Coverdell ESA distributions (educational IRA) – The definition of eligible educational expenses that may be paid tax free by this IRA is expanded to include kindergarten through high school costs
  - College tuition deduction – An above-the-line deduction for up to \$3,000 of college tuition and related fees is allowed to unmarried filers with MAGI up to \$65,000 and joint filers with MAGI up to \$130,000. The deduction is not allowed if a Hope of Life-Time Learning Credit is claimed for the same student for the same year
  - Qualified Tuition Programs – distributions from state-maintained qualified tuition programs are tax free if used for qualified expenses
  - Coordination of education benefits – Tax free treatment can be claimed for a distribution from an educational ESA, or a qualified tuition plan in the same year as an education credit is claimed

for the same student provided the distribution is not used to cover the same expenses used to figure the credit

- Employer-provided tuition assistance – The \$5,250 exclusion from income for employer-provided tuition assistance applies to all years after 2001 and is now available for graduate-level courses
- IRS business mileage rate 36.5 cents
- Hybrid gas-electric cars have been certified as being eligible for a \$2,000 clean-burning fuel deduction
- Inflation-adjusted limits on depreciation deductions for luxury cars remain the same for cars placed in service during 2002, but the first-year limit may be higher for cars eligible for bonus depreciation
- Sec 179 deduction for 2002 is \$24,000; other depreciation changes addressed in business changes
- Estate tax exclusion – In addition to the top rate coming down 5% to 50%, the pre-estate exclusion amount is increased to \$1M (to be reviewed for repeal in 2010)
- In summary FYI things to keep in mind:
  - National Research Program to detect compliance measures as the group studies the average returns looking for items that may substantiate an audit
  - IRS matching the donation of vehicles to charities
  - New Taxpayer Advocate Contacts System

### **Businesses**

- Businesses with average annual gross receipts of \$10 million or less over a 3 year period are now eligible to use a cash method of accounting for safe harbor
- Standard mileage rate increases to 36.5 cents
- Hybrid gas-electric cars have been certified as being eligible for a \$2,000 clean burning fuel deduction
- Allows an additional 30% first-year depreciation deduction for eligible property:
  - Acquired after September 10, 2001 and before September 11, 2004; placed in service by January 1, 2005
  - Subject to Code Sec. 263A uniform capitalization rules; production period greater than 2 years, or greater than one year and a cost exceeding \$1M; MACRS recovery period of at least 10 years
  - ADS property does not qualify, no AMT adjustment is required
  - Qualified Leasehold Improvement property – not for enlargements, elevator/escalator, structural components for a common area, and internal structural frame work; use normal recovery period for QLI
- Inflation-adjusted limits on depreciation deductions for luxury cars remain the same for cars placed in service during 2002, but the first-year limit may be higher for cars eligible for bonus depreciation
- Sec 179 deduction for 2002 is \$24,000
  - Increase Sec 179 deduction for Enterprise Zone Business placed in service during 2002 the deduction has been increased to \$35,000, no change on all other zones has been noted
  - Increase Sec 179 deduction for businesses in the Liberty Zone:
    - Property directly impacted by September 11, 2001
    - A special version of the 30% bonus depreciation allowance
    - Sec 179 deduction increase to \$35,000
    - A five-year/straight line recovery period for qualifying leasehold improvements
- Per diem rates for 2002 high-low method of substantiating travel - \$204 for high-cost and \$125 for low-cost zones
- New credit for New York Liberty Zone business employee – you may qualify if you pay or incur qualified wages to a Liberty Zone business employee; the credit is for wages paid or incurred to new and existing employees for work performed during 2002, or 2003

- Five-Year Carry Back for 2002 Losses (Job Creation and Worker Assistance Act of 2002) to Presidential declared disasters (individuals can use this for operating losses attributed to casualty and theft losses)
- Small Employer Credit for Retirement Plan Startup Costs:
  - Less than 100 employees with no qualified retirement plan can claim a tax credit for the administrative costs in setting up a pension plan, profit-sharing plan, 401(K), SEP, or SIMPLE plan
  - At least 1 non-highly compensated employee must be covered
  - Maximum credit is \$500, 50% of the first \$1,000 of startup costs and in the preceding two years afterwards
- A corporation or partnership with less than \$250K in assets not required to file M-1, M-2 (Page 4) balance sheet information
- In summary FYI things to keep in mind:
  - Tax shelter disclosure statement
  - Schedule K-1 matching by IRS
  - Reasonable compensation to S Corporation shareholders-employees

### **Errors commonly made in 2001**

- Rate reduction credit was not claimed
- Rate reduction credit was not allowed; received the maximum in 2001 or reported no taxable income
- Tax was figured or entered incorrectly
- Taxpayer identification numbers or names for dependents didn't match IRS or SSA records
- Taxable amount of social security benefits for page 1 was figured incorrectly

### **Economic Growth and Tax Relief Reconciliation Act of 2001 Reminders**

- A new 10% bracket and reductions to other taxes for 2001 and beyond (defer taxes or revenues if at all possible)
- The eventual repeal of the itemized deduction and personal exemption phase-outs
- Increases to the child tax credit for 2001 and beyond
- Changes to the dependent care credit and adoption credit for individuals; new general business credit for employers providing child care
- Changes to the student loan interest deduction and the education IRA rules, as well as a new 2002 "above-the-line" deduction for higher education expenses
- Numerous changes regarding pension contributions, funding, distributions and rollovers
- A short deferral period for all or part of the required corporate quarterly estimated tax payments due in September 2004
- Increases to the AMT exemption amounts for 2001-2004
- See Chart outlining tax changes over the next 4 years on next page

## Summary of Tax Changes

|                         | 2002     | 2004     | 2003     | 2005     |
|-------------------------|----------|----------|----------|----------|
| Tax rate brackets       |          |          |          |          |
| 36.9%                   | 38.6%    | 38.6%    | 37.6%    | 37.6%    |
| 36%                     | 35%      | 35%      | 34%      | 34%      |
| 31%                     | 30%      | 30%      | 29%      | 29%      |
| 28%                     | 27%      | 27%      | 26%      | 26%      |
| 15%                     | 15%      | 15%      | 15%      | 15%      |
| Child tax credit        | \$600    | \$600    | \$600    | \$700    |
| IRA Contributions       | \$3,000  | \$3,000  | \$3,000  | \$4,000  |
| IRA Catch-ups           | \$500    | \$500    | \$500    | \$500    |
| Elective Deferrals      | \$11,000 | \$12,000 | \$13,000 | \$14,000 |
| Elective Catch-ups      |          |          |          |          |
| -401(K) and SIMPLEs     | \$500    | \$1,000  | \$1,500  | \$2,000  |
| -Other plans            | \$1,000  | \$2,000  | \$3,000  | \$4,000  |
| AMT Exemption           |          |          |          |          |
| -Single                 | \$35,750 | \$35,750 | \$35,750 | \$33,750 |
| -Married filing jointly | \$49,000 | \$49,000 | \$49,000 | \$45,000 |
| Estate Tax              |          |          |          |          |
| -Top rate               | 50%      | 49%      | 48%      | 47%      |
| -Exemption amount       | \$1M     | \$1M     | \$1.5M   | \$1.5M   |

---

### **Bibliography:**

- U.S. Master Tax Guide, 2002, 86<sup>th</sup> ed., Edward Jones, pgs 8-9; CCH Incorporated, Chicago
- J.K. Lasser's 'Your Income Tax 2003' (Professional Edition) 66<sup>th</sup> ed., J.K. Lasser Institute, pgs xxv-xxix, John Wiley & Sons, Inc, Hoboken, NJ
- 2003 Tax Hints – Practitioner's Guide to the Filing Season, IRS, [www.irs.gov](http://www.irs.gov)



- Continuing care facility donations
- Health reimbursement accounts
- Final ruling on new home sale exclusion rules
- New York Liberty Zone
- Victims and Survivors of Terrorist Attacks
- IRA Changes:
  - Traditional IRA and Roth IRA contribution limits
  - Traditional IRA deduction phase-out
  - New life expectancy tables to compute IRA minimum distributions
  - IRS can waive 60-day rollover period
  - Retirement savings credit
  - Effective deferrals
  - Higher deductible contribution limits for SEP and Keogh plans
  - Expanded rollover options
  - Faster vesting for matching contributions
- Educational Changes:
  - Coverdell ESA contributions (educational IRA) – The annual contribution limit jumps from \$500 to \$2,000 per beneficiary. For married persons filing jointly, the contribution phase-out range increases to MAGI of \$190,000 - \$220,000, double the range for single filers. Contributions for 2002 can be made until April 15, 2003

- Coverdell ESA distributions (educational IRA)
- College tuition deduction
- Qualified Tuition Programs
- Coordination of education benefits
- Employer-provided tuition assistance
- IRS business mileage rate 36.5 cents
- Hybrid gas-electric cars
- Inflation-adjusted limits on depreciation deductions for luxury cars remain unchanged
- Sec 179 deduction for 2002 is \$24,000
- Estate tax exclusion
- In summary FYI things to keep in mind:
  - National Research Program to detect compliance measures as the group studies the average returns looking for items that may substantiate an audit
  - IRS matching the donation of vehicles to charities
  - New Taxpayer Advocate Contacts System

### **Businesses**

- Safe harbor cash method of accounting
- Standard mileage rate increases to 36.5 cents
- Hybrid gas-electric cars
- Job Creation Act of 2002
- Inflation-adjusted limits on depreciation deductions for luxury cars

- Sec 179 deduction for 2002 is \$24,000
  - Increase Sec 179 deduction for Enterprise Zone Business
  - Increase Sec 179 deduction for businesses in the Liberty Zone:
- Per diem rates for 2002 high-low method of substantiating travel - \$204 for high-cost and #125 for low-cost zones
- New credit for New York Liberty Zone business employee
- Five-Year Carry Back for 2002 Losses
- Small Employer Credit for Retirement Plan Startup Costs
- A corporation or partnership with less than \$250K in assets not required to file M-1, M-2 (Page 4) balance sheet information
- In summary FYI things to keep in mind:
  - Tax shelter disclosure statement
  - Schedule K-1 matching by IRS
  - Reasonable compensation to S Corporation shareholders-employees

### **Errors commonly made in 2001**

- Rate reduction credit was not claimed
- Rate reduction credit was not allowed; received the maximum in 2001 or reported no taxable income
- Tax was figured or entered incorrectly
- Taxpayer identification numbers or names for dependents didn't match IRS or SSA records
- Taxable amount of social security benefits for page 1 was figured incorrectly

### **Economic Growth and Tax Relief Reconciliation Act of 2001 Reminders**

- A new 10% bracket and reductions to other taxes for 2001 and beyond (defer taxes or revenues if at all possible)
- The eventual repeal of the itemized deduction and personal exemption phase-outs
- Increases to the child tax credit for 2001 and beyond
- Changes to the dependent care credit and adoption credit for individuals; new general business credit for employers providing child care
- Changes to the student loan interest deduction and the education IRA rules, as well as a new 2002 "above-the-line" deduction for higher education expenses
- Numerous changes regarding pension contributions, funding, distributions and rollovers

- A short deferral period for all or part of the required corporate quarterly estimated tax payments due in September 2004
- Increases to the AMT exemption amounts for 2001-2004
- Chart outlining tax changes over the next 4 years

## Summary of Tax Changes

|                         | 2002     | 2004     | 2003     | 2005     |
|-------------------------|----------|----------|----------|----------|
| Tax rate brackets       |          |          |          |          |
| 36.9%                   | 38.6%    | 38.6%    | 37.6%    | 37.6%    |
| 36%                     | 35%      | 35%      | 34%      | 34%      |
| 31%                     | 30%      | 30%      | 29%      | 29%      |
| 28%                     | 27%      | 27%      | 26%      | 26%      |
| 15%                     | 15%      | 15%      | 15%      | 15%      |
| Child tax credit        | \$600    | \$600    | \$600    | \$700    |
| IRA Contributions       | \$3,000  | \$3,000  | \$3,000  | \$4,000  |
| IRA Catch-ups           | \$500    | \$500    | \$500    | \$500    |
| Elective Deferrals      | \$11,000 | \$12,000 | \$13,000 | \$14,000 |
| Elective Catch-ups      |          |          |          |          |
| -401(K) and SIMPLEs     | \$500    | \$1,000  | \$1,500  | \$2,000  |
| -Other plans            | \$1,000  | \$2,000  | \$3,000  | \$4,000  |
| AMT Exemption           |          |          |          |          |
| -Single                 | \$35,750 | \$35,750 | \$35,750 | \$33,750 |
| -Married filing jointly | \$49,000 | \$49,000 | \$49,000 | \$45,000 |
| Estate Tax              |          |          |          |          |
| -Top rate               | 50%      | 49%      | 48%      | 47%      |
| -Exemption amount       | \$1M     | \$1M     | \$1.5M   | \$1.5M   |

---

### **Bibliography:**

- U.S. Master Tax Guide, 2002, 86<sup>th</sup> ed., Edward Jones, pgs 8-9; CCH Incorporated, Chicago
- J.K. Lasser's 'Your Income Tax 2003' (Professional Edition) 66<sup>th</sup> ed., J.K. Lasser Institute, pgs xxv-xxix, John Wiley & Sons, Inc, Hoboken, NJ
- 2003 Tax Hints – Practioner's Guide to the Filing Season, IRS, [www.irs.gov](http://www.irs.gov)

## **2002 Tax Update Seminar** **(Supplementary Information)**

- Roth IRA contributions are not deductible for tax purposes – and no taxes are paid in the distributions after the age requirement. However, maximum yearly amount to contribute is \$3,000. The income phase-out limits of being able to contribute to such an account begin with MAGI \$95,000 and \$110,000 (S), \$150,000 and \$160,000 (MFJ)
- Cash Method Safe Harbor – two rulings exist, \$5 million or less and \$10 million or less:
  - \$5 million or less – Personal service corporations in the fields of medicine, law, engineering, accounting, architecture, performing arts, actuarial science, or consulting. To qualify, substantially all of the stock must be owned directly or indirectly by employees (by partnerships, S corporations, or personal service corporations). Rules for a C corporation are if the production, purchase, or sale of merchandise is not an income-producing factor, the cash method may be used by a C corporation or a partnership with a C corporation as a partner if the average annual gross receipts over the prior three-year period were \$5 million or less
  - \$10 million or less – This limit is available for partnerships, S corporations, and C corporations with the exception of those barred by Revenue Procedure 2002-28 (business with principal activity that produces the largest gross receipts in the areas of retail or wholesale sales, manufacturing (other than eligible custom manufactures), publishing, sound recording, or mining)
- Qualified Leasehold Improvement property normal recovery period for the bonus depreciation plan – this property is defined by the improvement to an interior portion of nonresidential real property (cabinets, furniture/fixtures, interior design upgrades – upgrading carpets, wallpaper, desks, and other items that do not change the structural component of the unit or increase the unit overall size but are not classified as repairs or normal operating requirements by that particular business)
- Five-year carry back rule for businesses vs. individuals – the difference is individuals are allowed to use the new rule for any loss that they have incurred in 2001 or 2002 for theft or casualty (capital losses are deductible only to the extent of capital gains), businesses can only elect the five-year carry back if in a Presidential Declared Disaster area and your loss is contributed from the business events stemming from that disaster period or area