

TAX TIDBITS

2001 - A Taxing Year

None of us will ever forget the changes that have been imposed on the lives of all Americans this year. As the year began, our economy was already suffering from a downturn in the market, eroding retirement savings, and capital investments after a decade of prosperity and growth. With our financial security in question, we were then hit with the attack of September 11 forever changing the way we view our world. Followed by bioterrorism in the form of Anthrax delivered with our mail, whether by foreign or domestic enemies, our personal safety is something we can no longer take for granted.

Our tax lives have changed as well. In response to the

economic downturn earlier this year, President Bush signed the Economic Growth and Tax Relief Reconciliation Act, a bill which encompasses 441 Internal Revenue Code changes and will span the next 10 years. This bill calls for a \$1.35 trillion tax cut, the largest in 20 years and already implemented in the form of tax rebates sent to every taxpayer this summer. It calls for tax rate cuts, elimination of the itemized deduction/personal exemption limitations, marriage penalty relief, doubles the child tax credit, increases the adoption credit and the dependent care credit, calls for a repeal of the estate tax, and many other provisions that will affect every taxpayer in every income bracket.

To compound an already complex tax system,



Donna Simonson
Tax Department Manager

Congress is working on more tax legislation in the form of an economic stimulus bill that is expected to be passed before the end of the year. To take advantage of the benefits and avoid the traps of the revised tax code, tax planning for 2001 and throughout the next decade is no longer an option, but an ongoing necessity. Call us today to get started. Financial security happens when preparation meets opportunity.



Valicenti
Advisory
Services, Inc.

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Highlights of the Tax Relief Act of 2001:

- \$1.35 Trillion Tax Cut
- 10-Year Scope
- 85 Major Provisions
- 291 Pages of Official Bill Text
- Top Rate Phases down to 35%
- Increased 401(k) and IRA Contributions
- Alternative Minimum Tax Relief
- Estate Tax Repeal

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Electronic Filing Has Arrived

Clients of Valicenti Advisory Services, Inc., will have the option of having their tax returns filed electronically this year. Last year over 40 million tax returns were electronically filed with the IRS. Electronic Filing or E-Filing as the IRS refers to it, is a fast, accurate, safe, and

paperless way to file a return. You save time, you save postage, and you save a few trees. Also, if you are due a refund, e-filing will cut the time you receive it by half. It's even faster if you have it directly deposited into your account. If you have a balance due, you can e-file and e-pay at the

same time. You can e-pay with a credit card (and maybe earn frequent flyer miles or other rewards) or have a direct debit from your checking or savings account.

If you file early, you can have the debit delayed up to the due date of the return.

Child-Related Tax Relief

- **Child Tax Credit**
The Child Tax Credit will double to \$1,000 by 2010. The phase-in is \$600 for 2001 to 2004, \$700 for 2005 to 2008, \$800 for 2009, and \$1,000 for 2010 and later.
- **Adoption Credit**
The new law increases the credit for adoptions to \$10,000 for both special needs and non-special needs adoptions starting in 2002.
- **Dependent Care Tax Credit**
The new law increases the dependent care credit from 30 to 35 percent, and the amount of eligible expenses from \$2,400 to \$3,000 for one child and from \$4,800 to \$6,000 for more than one child.
- **Education Credits**
The College Tuition Deduction

doesn't go into effect until 2002 when a single taxpayer with adjusted gross income below \$65,000 (\$130,000 if married) will be entitled to a deduction of \$3,000. This deduction increases to \$4,000 for 2004 and 2005. This deduction cannot be claimed in the same year as a HOPE or Lifetime Learning Credit for the same student.

- **Education IRAs**
Currently contributions are limited to \$500 per child. Beginning in 2002 the amount you can contribute increases to \$2,000. Although contributions are not deductible, earnings accumulate tax-free and distributions to pay for qualifying education expenses are also tax-free. Also starting in 2002, distributions can be used for elementary and secondary-school expenses, including tuition at private and parochial schools.



The new Tax Law enhances many deductions and credits for children

- **Prepaid Tuition Plans**
Contributions to prepaid tuition plans and state-sponsored college savings accounts, also known as "529" plans, are not tax deductible but distributions will become completely tax-free starting in 2002. In 2004, plans for private colleges and universities will be included.

The Dreaded AMT



The AMT has been a headache for many taxpayers.

The Alternative Minimum Tax (AMT) was enacted by Congress in 1969 to prevent wealthier individuals from using various credits, deductions, and other tax breaks to slash their tax liability to little or nothing. Taxpayers calculate their regular tax bill first under the conventional method, then under the AMT, which adds certain deductions and credits back to income, subtracts an exemption (currently \$45,000 for joint returns, \$33,750 for

singles and heads-of-household) and computes the tax on the adjusted income. The taxpayer pays whichever tax is higher. While the AMT rates of 26 and 28 percent are lower than the top regular rates, the AMT rates are assessed on a much broader base of income and because the exemptions have not been adjusted for inflation since 1986, more and more taxpayers are being caught in the AMT trap as wages rise.

The Tax Relief Act of 2001 will cause millions more taxpayers to be subject to the AMT in the years ahead. Although the new law does provide for an increase in the exemption amount - \$4,000 for joint returns and \$2,000 for single individuals - lasting only until 2004, the change will have little effect. Other changes in the law will greatly exacerbate the problem; namely, a reduction in regular rates causes the differences between the regular tax and

the AMT tax to shrink as time goes on. Those affected will find the AMT re-inflating their tax bills and complicating the process of filling out tax returns.

Tax planning is also more complicated due to the AMT since it's often hard to predict when the AMT will kick in and the benefit of tax breaks will be lost due to the number of variables involved in the calculation. Some common deductions disallowed in calculating the AMT are: personal exemptions, the standard deduction, miscellaneous itemized deductions, interest on home equity loans not used for improvements, state, local, or foreign taxes, some investment interest expenses, and some passive activity losses.

There are some strategies for limiting the impact of the AMT but they do require careful advanced planning.

Retirement Savings & Pension Reform

There is much in the new law to like about the provisions for retirement savings and pension funds. Below is a recap:

Defined Benefit Plans

The annual limit on benefits have been increased from \$140,000 to \$160,000 for taxable years ending after December 31, 2001.

Defined Contribution Plans

Starting in 2002, the limit on annual contributions will increase to \$40,000.

401(k) Contribution Limits

Salary reduction contributions to 401(k)-type plans (including 403(b) and SEP plans) will increase from \$10,500 to \$11,000 in 2002 and

\$1,000 each year until 2006 when the limit will be \$15,000. Catch-up provisions will allow participants age 50 and above to contribute an additional \$1,000 in 2002, increasing to \$5,000 by 2006.

IRAs

Contribution limits for both traditional and Roth IRAs will increase from \$2,000 to \$3,000 for tax years 2002 through 2004, then up to \$5,000 by 2008. The bill extended "catch-up" provisions to those 50 and over with an extra \$500 for 2002 through 2005 and an extra \$1,000 for 2006 and beyond.

New Distribution Rules

Since 1987, taxpayers have agonized over the minimum distribution rules

that required complex irrevocable decisions that often resulted in high costs if the wrong decision was made. On January 11, 2001, the Treasury Department revised and simplified the regulations which will make it much easier to designate beneficiaries and determine minimum distributions, which will make both lifetime and postmortem planning easier. IRA owners may take advantage of the new regulations immediately, but participants in qualified retirement plans must wait until employers amend their plan provisions, which should be effective by January 1, 2002.



Retirement might be a little easier for taxpayers under the

Dearly Departed.....

Congress has been wrangling with the estate and gift tax regulations for years and they finally came up with new provisions that completely repeals the estate tax by 2010. The caveat here is that, if the provisions aren't renewed in 2011, the rates and exemptions revert to pre-2002 levels.

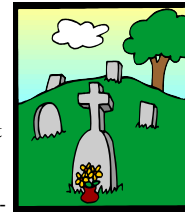
Beginning in 2002 the top gift, estate, and generation-skipping is reduced from 55% to 50%. The rates

continue to drop each year until the repeal in 2010, then revert back to 55% if allowed to expire.

The exemption amount, currently \$675,000, will increase to \$1 million in 2002, and every year until 2010.

Starting in 2002, the unified credit will be replaced by a unified exemption and the generation-skipping transfer tax will be assessed at the highest estate tax rate.

Even if the new rules are allowed to expire, taxpayers can take advantage of the increased amount that is exempt from gift tax and pass after-tax assets on to beneficiaries outside the estate.



Limit Communication with the IRS

Starting with tax returns for 2000, the IRS added a new checkbox feature giving taxpayers the option of allowing their paid preparers to directly answer tax processing questions. This change will improve communications and reduce the number of IRS letters to taxpayers.

Taxpayers may check this box to authorize the IRS to discuss processing problems over the phone directly with the paid preparer who signs the return.

By checking the "YES" box in the

signature area of the tax return, you authorize the paid preparer to:

- Give the IRS any information that is missing from your return.
- Call the IRS for information about the processing of your return or the status of your refund or payment.
- Respond to certain IRS notices that you have shared with the preparer about math errors, offsets, and return preparation. However, these notices will not be sent to the preparer.

Using the checkbox does not authorize the paid preparer to receive any refund check, bind you to anything (including any additional tax liability) or otherwise represent you before the IRS.

The checkbox authorization will automatically end no later than the due date (without regard to extensions) for filing your 2001 return. The checkbox authorization cannot be revoked.



Asset management
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Asset Management

One of the benefits of having your assets managed by Valicenti Advisory Services, Inc., is a complete management service, which includes a reconciliation of the year's activity under the report called Tax Summary. This is mailed to clients by February 1 for the calendar year. The report includes all the income received including accrued interest paid, deductible fees, any withdrawals that could be considered to be deductible expenses, and capital gains and losses, which is the Schedule D on the 1040 tax return.

If you want to consider having your assets managed by Valicenti Advisory Services, Inc., please call Ralph Roberts or Michael Valicenti using the numbers listed next to this article or visit our Website.



www.valicenti.com

Preparing for Your Preparer

Whether you use a paid preparer or take on the task yourself, there are some basic guidelines to make the endeavor less taxing (excuse the pun):

1. **Keep Good Records**

Keeping good records throughout the year is your best defense against the taxman. It provides you with the information you need for interim planning and adjusting withholding and/or estimates.

2. **Start Early**

Starting early to gather your tax info (especially if you failed with rule No. 1) will give you a chance to organize your documentation and obtain any missing information without the stress of bumping up against the deadline.

3. **Be Alert**

Even if you use a paid preparer,

you are ultimately responsible for your tax return and the information on it. A general familiarity with the basic tax rules and forms will enable you to review your return with some confidence, catch obvious errors, or, if preparing your own return, feel comfortable about what you are filing with the IRS. It is also beneficial in recognizing taxable events throughout the year and adjusting your tax plan accordingly.

4. **Be First On Your Block**

Make an appointment with your tax preparer as soon as you have all your documents. This will give him/her time to review your income and expenses and develop strategies for minimizing your tax liability.

5. **Keep In Touch**

You should contact your preparer whenever taxable events (such as purchase or sale of an asset, job change, birth of a child) occur throughout the year. This will allow you time to take advantage of strategies that may take several months to implement.



It's best to start early especially if your financial life is complex