

TAX TIDBITS

2002 - A Year of Uncertainty

It's hard to believe that another year has gone by and it's almost time to review our finances and get ready to report our pluses and minuses to the US Treasury.

2002 has been a year of uncertainty as we've hunted terrorists and mad anthrax distributors, been attacked by snipers, and now prepare for the possibility of war with Iraq. In the meantime, the stock market has continued its downward slide, occasionally producing an upward bounce that brings a gleam of hope to our eyes only to disappoint us once again with another retreat. Our faith in those that run our corporations and those that provide oversight has been deeply eroded by the scandals at Enron, Worldcom, Adelphia, Tyco, Global Crossings and others.

Is there any good news?

Yes, the good news is that Americans are resilient, industrious, and caring. This is displayed every day by the response to events such as the WTC attack where billions of dollars and thousands of man-hours were donated for the recovery; where the hard work of law enforcement and the involvement of average citizens removed a sniper from our streets; where optimistic investors kept their money invested in this country because they believe the stock market will recover and honest men and women will once again bring prosperity to our corporations and the nation.

There have been more changes to the tax law in an effort to boost the economy. Besides being the second year of the Tax Relief Act of 2001, in March President Bush signed the Job Creation and Worker Assistance Act of 2002, which allowed for a 30% first-year depreciation deduction for



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qualified property purchased after September 10, 2001, and before September 11, 2004. Other changes include an increase in the luxury auto depreciation limit by \$4,600, an extension of the Net Operating Loss carryback period from 2 or 3 years to 5 years, plus some minor changes for specific groups. These changes affected some 2001 tax returns that had already been filed and needed to be amended after the act was passed.

Any review of your 2002 finances should include these changes.



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The Tax Relief Act of 2001: Year 2

- *Contribution Limits for Retirement Plans Increase*
- *Contribution Limits to Education IRA's Increase*
- *Tax Rates Decrease*
- *Estate Tax Exemption Increases to \$1 million and the Rate Drops to 50%*
- *60-Month Limit for Student Loan Interest Deduction is Eliminated.*
- *New College Tuition Deduction up to \$3,000*

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April 15 - The Deadline (a history lesson)

Maybe you've wondered (and maybe you haven't) how the IRS determined that April 15 would be the deadline for most Americans to file their income tax returns. Actually the IRS had little to do with it. When the 16th Amendment, which authorized Congress to implement an income

tax, was adopted on February 3, 1913, Congress chose March 1 of the following year as the deadline for the first income tax returns. Then, with the passage of the Revenue Act of 1918, the deadline was moved to March 15 for no apparent reason (could've even been a typo). The current deadline of April 15 came in

1955 buried in a variety of tax code revisions. There were two reasons: first, to spread out the workload for the IRS; second, as more people had withholding which resulted in refunds, it allowed the government to keep the money longer....hmmmmm!

Retirement Contributions for 2002

- **Defined Contribution Plans**

For 2002, the limit on total contributions will rise to \$40,000 (up from \$35,000), and the amount of income base increases to \$200,000.

- **401(k) Plans**

The amount you can contribute to your 401(k) plan increases to \$11,000 (up from \$10,500). This limit also applies to 403(b) plans & SEP-IRAs.

- **Simple IRAs**

The limit for Simple IRAs increases to \$7,000.

- **Defined Benefit Plans**

The annual limit on benefits increases from \$140,000 to \$160,000.

- **IRAs**

For the first time in 15 years, IRA contribution limits will rise to \$3,000 for 2002-2004. Taxpayers age 50 and above will be permitted to contribute an additional \$500. This assumes that you are eligible to contribute since the income phaseouts for both Traditional and Roth IRAs remain the same.

- **Retirement Tax Credit**

Lower income workers will be entitled to a tax credit of up to 50 percent in addition to any otherwise allowable retirement contribution deduction. The maximum contribution eligible for the credit is \$2,000 for a maximum credit of \$1,000. The credit is subject to



Increased limits on retirement contributions will allow taxpayers to better plan for their future.

income phaseouts of \$15,000, AGI for single taxpayers, \$22,500 for head of household, and \$30,000 for married filing jointly.

Tax Relief for Education



Saving for future education expenses is becoming easier.

In an effort to provide incentives for saving for the ever-escalating costs of a child's education, Congress has included several enhancements to the tax code.

529 College Savings Plans

One of these saving incentives is the 529 College Savings Plan. It is designed to help families save for future qualified higher education expenses. Contributions to these savings plans, increased from \$500 to \$2,000 in 2002, are not tax-deductible, but provisions in the code allow for the earnings to grow tax-deferred until the funds are withdrawn to pay for qualified higher

education expenses. Effective January 1, 2002, withdrawals used for qualified college expenses are free of federal tax. In addition, qualified college expenses includes off-campus housing.

Education Savings Accounts

Formerly known as Education IRAs, Education Savings Accounts (or Coverdell Education Savings Accounts) are more attractive than they've ever been before. Starting in 2002, maximum contributions are increased from \$500 to \$2,000 and you have until April 15 to make the contributions rather than the old deadline of December 31. Distributions from ESAs are tax-free if used to pay for qualified education expenses which have been expanded to include expenses for elementary and secondary, both public and private schools. Covered expenses include tuition, tutoring, computer equipment, room and board, uniforms, and extended day program costs. You are also allowed to continue contributing after the beneficiary turns 18 if he or she is a "special needs beneficiary". Starting in 2002, contributions can be made by

corporations, tax-exempt organizations and other entities, which could be helpful for small business owners and the self-employed. You'll also be able to claim the HOPE and Lifetime Learning tax credits in the same year you make ESA distributions provided distributions don't pay for the same costs used to claim the education credits.

Student Loan Interest

For tax years beginning in 2002, the 60-month limit on student loan interest deductibility has been repealed and the income phaseout ranges have been raised to \$55,000—\$65,000 for singles and \$100,000 to \$130,000 for married filing jointly. The deduction is limited to \$2,500.

College Tuition Deduction

For tax years 2002-2003, single taxpayers with AGI below \$65,000 and married taxpayers with AGI below \$130,000 are allowed a deduction from income of up to \$3,000 of tuition and fees for the taxpayer, spouse, or a dependent child.

Tax Breaks for a Bad Year

Whether you've been affected by the plunging stock market, corporate downsizing, or you just didn't get that raise or bonus you had planned on, chances are this year hasn't been as good as you'd hoped. If so, you have my sympathy and welcome to the club!

But, remember, every cloud has a silver lining and your lowered financial circumstances may open up some tax saving opportunities that weren't available to you at higher income levels.

AGI-Sensitive Tax Breaks

The Child Tax Credit is available to single taxpayers with AGI below \$75,000 and married taxpayers with AGI below \$110,000. The credit is \$600 for each dependent child under the age of 17.

Rental Properties allow you to deduct up to \$25,000 of losses if your AGI is \$100,000 or less. With AGI between \$100,001 and \$150,000, you can deduct a portion of your rental

losses.

Review the other AGI-sensitive credits and deductions discussed in this publication, such as education deductions and retirement contributions, that you might not have been eligible for in the past.

If you find that your AGI is still a little too high to qualify for some of these tax breaks, here are some steps you can take to further reduce it:

1. Sell some of those loser stocks and mutual funds from your taxable investment accounts. The losses will first offset any capital gains realized this year (as if you had any), but then you can deduct up to \$3,000 against your income from any other source. Losses in excess of the \$3,000 can be carried over to 2003, which we hope will be a better year.
2. Catch up on deductible alimony payments before year-end. This will reduce your taxable income

and your AGI and might make the difference for other tax deductions and credits that will lower your tax bill.

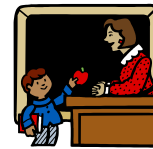
3. If you're self-employed, defer income until 2003 and accelerate deductible expenditures into 2002.



Being down on your luck can mean tax savings

You can claim 2002 deductions for expenses charged this year to a credit card even though you won't pay for them until 2003.

If you were temporarily or permanently downsized and collected unemployment benefits, remember that this benefit is taxable income and should be included in your year-end planning.



New Deduction for Teachers

Beginning in 2002, eligible educators will be able to deduct, as an adjustment to income, up to \$250 in qualified unreimbursed expenses paid for books, supplies, computer equipment (including related software and services), other equipment, and supplies or materials used in the classroom.

To be deductible, the qualified expenses must be more than the following amounts for the tax year:

1. The interest on qualified US savings bonds that you excluded from income because you paid qualified higher education

expenses.

2. Any distribution from a qualified tuition program excluded from income, or
3. Any tax-free withdrawals from a Coverdell Education Savings Account.

Get the Most from your Mileage



The IRS allows the use of a standard mileage rate for computing the deductible costs

of operating an automobile for business, charitable, medical, or moving expense purposes and it can really add up. To justify the deduction you must keep a record of

the miles driven, when, where, and for what purpose, but it could be worth it.

The amounts for the various deductible costs for use of a car for 2002 are as follows:

- The rate for the cost of operating a car is 36.5 cents a mile for all business miles driven.
- The rate for the use of a car when

giving services to a charitable organization is 14 cents a mile.

- The rate for use of your car for medical reasons is 13 cents a mile.
- The rate to use when computing deductible moving expenses is 13 cents a mile.

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)

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Tax Credits - Hidden Treasure

Ignoring tax credits is like tearing up a refund check. Unfortunately, too many people do it. Unlike deductions, which reduce income, each dollar of credit equals a dollar in tax savings.

People generally miss out on tax credits because they get in a hurry as the tax filing deadline approaches and they usually involve making additional computations or filling out extra forms. However, the effort could net you several hundred dollars. With that thought in mind, here are a few of the less common tax credits for individuals:

AMT Credit

If you paid the dreaded alternative minimum tax in a previous year, you may have generated an AMT credit, which you can use to reduce your 2002 tax bill. Use Form 8801 to compute this credit.

Foreign Tax Credit

If you've worked in a foreign country or have substantial income from foreign sources, you probably know all about the foreign tax credit. It's intended to keep you from being taxed on the same income by two different countries. But even if you simply invested in some international mutual funds or stock in a foreign corporation, you may also be able to collect this credit because it's likely you paid foreign taxes on the income. Review your investment statements and Forms 1099-DIV and 1099-INT for foreign tax paid. You can claim up to \$600 directly on 1040, Line 43. If more, then use Form 1116 to claim your credit.

Credit for Excess Fica Withheld

If you had more than one employer in 2002 and earned more than \$80,400 in combined wages, you most certainly had too much Social Security tax withheld. You can claim the excess by reporting the overpaid amount on Form 1040, Line 62.

If you use a paid preparer, make sure that these and other credits that you might qualify for are claimed. Provide any information that is needed to minimize your tax bill.



Tax Credits can be worth hundreds of dollars.