Everything Jersey

Don't get caught

From the AMT to college credits, filers face changes aplenty

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Sometimes, even the pros can't avoid the alternative minimum tax.

"I got hit with it this year," says Bernie Kiely, a certified public accountant and financial planner with Kiely Capital Management in Morristown. "There is absolutely nothing I can do about it."

Kiely says personal exemptions, high property taxes and high state income taxes are what led him to have to pay AMT in addition to the regular income tax on his return for 2004.

AMT, an alternative tax system, was enacted in 1996 to stop rich people with creative accountants and lawyers from avoiding taxes. Now, it's crunching thousands of ordinary Americans and it is expected to affect 30 million taxpayers by 2010.

In an attempt to provide some relief, the AMT exemption amount was increased in 2003 to $58,000 for married filers and $40,250 for singles. The Working Families Tax Relief Act of 2004 maintained the exemption levels for 2004 and 2005, providing some continued relief.

But AMT is still a threat to many. Traditional tax planning strategies such as deferring income and accelerating deductions could subject you to the AMT, Marnie Aznar, with Aznar Financial Advisors in Morris Plains, says.

"Prepaying your state tax liability prior to year-end would be effective planning under the ordinary income tax system, but could sometimes create an AMT problem," Aznar says.

The Internal Revenue Service's April 15 income tax filing deadline is only 40 days away. And whether you file your own taxes -- on paper or online -- or use a professional tax preparer, it is time to get ready and get going.

The extended AMT exemption increase is one of many changes for 2004 that you need to remember as you prepare your return. Here's a look at some of the other important issues:

Changes for everyoneRelief from the so-called marriage penalty, which impacts 40 percent of married couples, was also extended with the Working Families Tax Relief Act of 2004.

"When both incomes are combined, it pushes the couple into the next tax bracket, triggering higher taxes," Bill Connington, of Connington Wealth Management Group in Pine Brook, says. "The penalty can be steep especially if both couple's incomes are fairly equal."

But now, the standard deduction for joint filers and qualified widows has been increased by $1,650 to $9,500 -- twice that of a single filer or a married person filing separately. Also, the income level at which married taxpayers move into the 25 percent tax bracket has been raised to a level double that for single taxpayers.

Sales tax optionOne updated provision for 2004, thanks to the American Jobs Creation Act, allows taxpayers to choose between deducting state income tax and sales tax. It won't help New Jerseyans as much as residents of states that have state or local sales tax but no income tax, such as residents of Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming, Diahann Lassus, a CPA and financial planner with Lassus Wherley & Assoc. in New Providence, says.

Before 1986, taxpayers were allowed to deduct both state income tax and sales tax. The Tax Reform Act of 1986 eliminated the sales tax deduction.

Now, taxpayers who itemize can choose one or the other. You don't have to save all your sales tax receipts to take the deduction. As an alternative, you can use IRS tables, which are based on the average consumption of taxpayers on a state-by-state basis, taking into account a taxpayer's filing status, number of dependents, adjusted gross income and local general sales tax.

Then, in many instances, you can add sales taxes paid on a motor vehicle, an aircraft, a boat, a home or home building materials.

"It may give a larger deduction to any taxpayer who paid more in sales taxes than income taxes," Lassus says. "For example, a person may have bought a new car or boat, boosting the sales tax total, or claimed tax credits, lowering the state income tax paid."

Charitable givingThere are also changes if you made charitable contributions for tsunami relief.

If you made a contribution in January 2005, normally this would be deductible on your 2005 return. But if you contributed to a tsunami relief organization before Jan. 31, 2005, you have the choice of taking the deduction in 2004, or saving it for your 2005 return.

Free online filingAnother big change for 2004 is Free File, an online tax preparation and electronic filing service offered through a partnership between the IRS and the Free File Alliance, a tax software industry group.

Millions of taxpayers will be able to file federal returns for free, as long as they file through links on the IRS Web site at www.irs.gov. E-filing can speed up the filing process, and you may be able to get your refund faster. You'll still have to pay to file your state return, though.

Changes for investorsTax laws are more favorable for investors these days.

After May 5, 2003, the capital gains rate was reduced to 15 percent, from 20 percent, and to 5 percent, from 10 percent, for low-income earners. And dividends are taxed at the 15 percent or 5 percent rate (based on the individual's income) instead of at the investor's marginal tax rate.

Available for 2004, investors who have exercised incentive stock options or employee stock purchase plan options won't have to pay Social Security and Medicare taxes or Railroad Retirement taxes on the resulting compensation.

And if you have a disqualifying disposition of stock you acquired by exercising a statutory stock option, Lassus says your employer is no longer required to withhold federal income tax from your compensation if you exercised the option after the date the tax law was enacted.

IRA changesThough retirement plan contributions remain level for 2004, more people will be able to deduct at least a portion of their contributions to traditional IRAs.

Singles earning up to $45,000 get a full deduction, while a partial deduction is allowed for those earning between $45,000 and $55,000. For married couples, income under $65,000 gets them a full deduction, while the deduction phases out for those earning between $65,000 and $75,000.

Plus, the mandatory required minimum distribution from retirement plans is now included in modified adjusted gross income. In English, that means for many, this made a Roth IRA conversion impossible because their adjusted income exceeded $100,000, Connington says. That will change for 2005, as the distributions won't be included in the income category.

Dependent creditsParents will enjoy some increased benefits for 2004.

The child tax credit for 2003 and 2004 was increased to $1,000, from $500 per child, and it's scheduled to remain until 2010. And taxpayers could get a refund if a taxpayer's credits are greater than their tax.

"Previously, they could get a refund of the difference, up to 10 percent of the amount by which their 2004 taxable earned income exceeds $10,750," Kiely says. "This percentage was raised to 15 percent for 2004, meaning a larger refund for many of these taxpayers."

You may also benefit from the Child and Dependent Care Credit if you paid for someone to watch a child under age 13 or other dependent who is incapable of self-care while you worked or looked for work. The credit is a percentage based on your adjusted gross income, and can range from 20 percent to 35 percent of qualifying expenses (up to $3,000 for one person's care, $6,000 for two or more), depending on your income. That adds up to between $600 and $1,050.

College-boundIf junior headed off to college in 2004, families have more tax breaks than before, but Kiely says there's no double-dipping, as a taxpayer can only take one of the following breaks in any given year:

There's an increase in theLifetime Learning Credit.The credit amount is now equal to 20 percent of the taxpayer's first $10,000 of out-of-pocket qualified tuition and related expenses, doubling the maximum credit to $2,000. And the Hope Credit is $1,500 per student.

For 2004 returns, the tuition and fees deduction is up to $4,000 from $3,000 on qualified expenses. Remember this deduction is the same no matter how many students you've been paying for.

The full deduction is available for single filers who make less than $65,000 or married joint filers earning less than $130,000. There's a phase-out for singles earning up to $80,000 and married couples earning up to $160,000, and once you're beyond that level, you're out of luck.

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