

The Cost-of-Living Dollar Limits

for 2001 Tax Year

401(k) deferral limit \$10,500

Annual compensation limit \$170,000

Defined contribution IRC Sec 415 limit \$35,000

Compensation limit for SEP eligibility \$450

Deferral limit for SIMPLE \$6,500

IRC Section 179 \$24,000

Unified Credit Exclusion \$675,000

Self-employed health insurance AGI deduction 60%

Business mileage rate \$0.345/mile

Medical mileage rate \$0.12/mile

Charitable mileage rate \$0.14/mile

Automobile depreciation limit: first year \$3,060*

Second year \$4,900*

Third year \$2,950*

Each succeeding year \$1,775*

(*Unchanged from 2000)

Social Security

Wage Base for 2001 \$80,400

Retirees under 65 may earn up to \$10,680 (\$890 a month). For each \$2 earned over the amount for the year, the retiree loses \$1 in benefits. Retirees turning 65 in 2001 can earn up to \$25,000 a year without losing benefits, counting only earnings before the month they turn 65. For each \$3 earned over this limit, the retiree loses \$1 in benefits. No limit if 65 or over, effective January 1, 2000.

As you work and pay Social Security taxes, you earn "Credits", up to a maximum of 4 for each year. The amount of earnings it takes to earn a credit changes each year. In 2001, you earn one credit for each \$830 of your earnings. So if you have earned at least \$3,320 during the year, you get the maximum 4 credits.

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Tips, Tricks & Tools

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2001 Tax Law Summary

For more information regarding the new tax laws, visit our website at www.jajonescpa.com click on For Your Information and 2001 Tax Law Summary or www.newkirk.com/onlinepub/gtl2001/frameset1.cfm?CFID=194372&CFTOKEN=93241078

Some of the 529 Plan and Retirement Plan provisions are discussed in this newsletter.

Review Estimated Tax Payments

The recently enacted Economic Growth & Tax Relief Reconciliation Act of 2001 promises to deliver tax savings to nearly every American. Along with the rebate checks, you may have noticed a change in the amount of federal income taxes withheld from your paycheck as of July 1st. If you make estimated tax payments, you should review your September 15th and January 15th installment amounts. Your estimated tax payments were probably prepared based on the assumption that the amount of taxes withheld from wages would be at least the same as in 2000. This may no longer be the case, and you may need to make up the difference by increasing your estimated tax payment for the shortfall to avoid a penalty situation.

First Internet-Based System for Individual Tax Payments

Individuals and business will be able to pay all federal taxes through a secure website. This is an online version of the Electronic Tax Payment System (EFTPS) currently used by many businesses. This system offers a confirmation of each payment submitted and users will be able to research their electronic payment record online and cancel payments electronically.

Businesses and individuals can enroll in EFTPS-Online via the Internet. After enrollment, the taxpayer will receive a confirmation kit by mail with instructions for obtaining an Internet password. A unique PIN will be mailed separately to new EFTPS users for added security.

The program will allow individuals to schedule payments up to 365 days in advance (no more late estimated tax payments), while businesses can schedule payments up to 120 days ahead. Taxpayers will receive an instant, printable, EFT acknowledgment number to document the transaction.

For more information, visit www.eftps.gov or call 800-555-4477 or 800-945-8400.

Section 529 Plans Just Got Better

In previous issues of this newsletter, we have discussed the advantages of a Section 529 Plan as a means to save for your children's college education. These plans just got better. You will soon find more of these plans being offered by your broker and mutual funds, offering an even wider array of investment opportunities.

Starting in 2002 for state programs, and in 2004 for other qualified tuition programs, distributions or education benefits received are **excludable** from income.

Starting after 2001, educational institutions are allowed to sponsor plans; the definition of "member of the family" is expanded to include first cousins of the original beneficiary; and tax-free transfers from one qualified plan to another are permitted.

DEADLINES

October

15

Monthly-filers Form 941 federal tax deposit due

DC sales tax return and payment due, quarterly and monthly filers

Maryland income tax withheld return and payment due, monthly filers

Federal, DC and Maryland Individual Income Tax Returns final due date, if Form 2688 or additional extension was filed

20

Virginia and Maryland sales tax return and payment due, quarterly and monthly filers
DC income tax withheld return and payment due, quarterly and monthly filers

31

Form 941 due

Virginia income tax withheld return and payment due, quarterly and monthly filers

Maryland income tax withheld return and payment due, quarterly and monthly filers
State unemployment tax returns and payment due

Form 940 federal tax deposit due

November

1

Virginia Individual Income Tax Return, final due date if second Form 760-E was filed

15

Monthly-filers Form 941 federal tax deposit due

DC sales tax return and payment due, monthly filers

Maryland income tax withheld return and payment due, monthly filers

20

Virginia income tax withheld return and payment due, monthly filers
DC income tax withheld payment return and payment due, monthly filers

Virginia and Maryland sales tax return and payment due, monthly filers

December

15

Monthly-filers Form 941 federal tax deposit due

DC sales tax return and payment due, monthly filers

Maryland income tax withheld return and payment due, monthly filers

20

Virginia income tax withheld return and payment due, monthly filers
DC income tax withheld payment return and payment due, monthly filers

Virginia and Maryland sales tax return and payment due, monthly filers

31

Virginia, DC and Maryland individual estimated tax payment #4, if you itemize your deductions

Contribution to Education IRA due date
Last chance for making donations and other tax deductible payments

New Retirement Provisions

The new law provides significant incentives for individuals, individuals over 50 years old, and small business owners to increase their savings for retirement. Most of these changes will be effective in 2002 or later. However, **small business owners would be wise to have their retirement plans reviewed prior to the end of November of this year.**

For small business owners, many changes will require no action on their part. The limit on annual additions will increase from \$35,000 to \$40,000 for years after 2001. The maximum salary taken into account will increase from \$170,000 to \$200,000 for 2002 and after. After 2001, the 401(k) elective deferrals will not be considered employer contributions subject to the 15% deduction limit and the limit on employer contributions to profit sharing plans and SEPs will be increased from 15% to 25%. Faster vesting schedules will take effect for 401(k) matching contributions.

The maximum contribution through elective deferrals by employees increases to \$11,000 in 2002, and then rises \$1,000 annually to \$15,000 in 2006. Starting in 2002, individuals, age 50 or older, will be entitled to make "catch-up" contributions to their 401(k). The maximum catch-up contribution in 2002 is \$1,000, rising by \$1,000 each year to \$5,000 in 2006. These contributions are exempt from the normal dollar limits on 401(k) deferrals, so in 2002 an individual at least age 50 may make a maximum contribution of \$12,000 (\$11,000 plus \$1,000).

In 2006, a new "Roth 401(k)" will become available. This will give 401(k) savings the same tax treatment as a Roth IRA. Essentially, employees will be able to designate elective deferrals as after-tax contributions and all withdrawals from these plans will be tax-free if certain conditions are met.

Since the profit sharing contribution limit is being increased to 25%, those business owners with Money Purchase Pension Plans may want to freeze these plans and amend their Profit Sharing Plan documents to allow the 25% contribution. Some of the other provisions, like the "Roth 401(k)," will also require that the language in the plan be revised. Small business owners should also consider implementing a safe-harbor 401(k) plan.

IRAs. The new law increases the maximum IRA contribution: \$3,000 for 2002-2004; \$4,000 for 2005-2007, and \$5,000 (adjusted for inflation) for 2008 and after. These annual limits are increased by \$500 for 2002-2005 and \$1,000 for 2006 and after, for individuals who have reached the age of 50 by the end of the tax year and who meet the AGI limits.

Still Time to Undo 2000 Roth IRA Conversions

If you converted a traditional IRA to a Roth IRA last year, you have until October 15 to change your mind and undo the conversion. If you have filed your return, you will need to file an amended return to reflect the reversal.

This option permits you to undo a conversion for any reason and can be a godsend if you discover that your Roth IRA portfolio has declined sharply in value since the time of the conversion. See: www.taxplanet.com/taxcalendar/roth101501/roth101501.html.

Internet Sites to Visit

Virginia Employers: To file and deposit sales taxes and/or income taxes withheld online at no charge via iFile (EFT), visit www.tax.state.va.us and click on "File and Pay Withholding and Sales Taxes Online."

Restaurants and construction are among the first two of the IRS' new industry-specific websites with tax tips for small businesses and self-employed individuals. To see if the industry site for your company is up and running yet, go to www.irs.gov/smallbiz/index.htm

Dentist's Intraoral Camera Not Eligible for Tax Credit

The Tax Court has held that an intraoral camera system purchased by a dentist, which is generally useful in his practice, is not eligible for the tax credit as an eligible access expenditure, even if it helps him communicate with his hearing-impaired patients.

In 1995, the taxpayer (a self-employed dentist) purchased an intraoral camera system for use in his dental practice. The system has general applicability to and usefulness with all patients, reducing the time needed to explain diagnosis, procedures, and recommended treatment to them.

The taxpayer considered the system a more effective and efficient way to communicate with hearing-impaired patients. The taxpayer claimed the disabled access credit under IRC Sec. 44 for the cost of the system.

The Tax Court reasoned that the acquisition of the system did not enable the taxpayer to comply with the ADA (Americans with Disabilities Act) because he was already in compliance through the use of handwritten notes to communicate with his hearing-impaired patients. The system was neither a replacement for, nor an acceptable alternative to, handwritten notes for purposes of the IRC Sec. 44 credit.

The implications of this finding may easily be expanded to other dental equipment being promoted by equipment vendors as eligible for the ADA tax credit.

Simplified Rules for Retirement Plan Distributions

Most individuals must begin taking minimum annual distributions from their IRA, 401(k) or other qualified retirement plans no later than April 1 following the year in which they turn age 70 ½.

Simplified new rules permit smaller distributions. The new rules permit almost all individuals to use one uniform table for calculating lifetime required minimum distributions, regardless of who is named as beneficiary and without having to choose between methods of determining life expectancy. Under this table, life expectancy is computed on the assumption that there is a designated beneficiary who is 10 years younger. All participants and spouses use the recalculation method so that distributions may stretch over their entire lifetimes. Unlike the old rules, the use of the recalculation method does not increase the minimum amount of required post-death distributions to survivors and beneficiaries.

If you have begun receiving minimum distributions, you will want to recalculate how much you will need to withdraw for 2001 under the new rules and compare that figure to the required payout under the old rules.

IRA owners may, but are not required to, follow the new rules for 2001 distributions.

Relief for Victims of September 11, 2001 WTC and Pentagon Attacks

The IRS and the Dept. of the Treasury are providing relief to all taxpayers-regardless of where they reside-who are directly affected by the terrorist attacks. For example, this includes relief workers, the victims on the airplanes, taxpayers whose place of employment is in a disaster area, and taxpayers with records maintained in a disaster area. The five boroughs of New York city and Arlington County have been declared disaster areas. Additional details are available in Notice 2001-81 at <http://ftp.fedworld.gov/pub/irs-news/ir-01-81.pdf> or by calling our office.

Start Your Year-End Tax Planning Now

The first step is to look at this year's financial results year-to-date and also take a look at next year's expected results.

Time your year-end income and deductions. The general rule is to defer income into next year to postpone taxes, and accelerate deductions into this year. But if you expect to be in a higher income tax bracket next year, it may pay to do the reverse, realize income this year when it will be taxed at a lower rate, and save your deductions for next year when they will provide a greater tax savings.

Cash-basis business owners can time the sending of bills and invoices to your clients so that payments are received before, or after, year-end. You can also time the payment of expenses and choose to pay bills before or after the year-end. You can charge many of your deductible expenses on a general purpose credit card and take the deduction in the year that it was charged.

Be sure to take advantage of all available tax credits. Small business owners can get a 50% tax credit for the cost of removing barriers to disabled persons' access to the premises. This credit may also apply to new equipment that is designed to accommodate the disabled, but you should review the article above and the Tax Court case regarding the dentist's intraoral camera to be sure your acquisition qualifies. A company that hires new workers who have been on public assistance is also eligible for tax credits.

If you are thinking of purchasing new business equipment, **the IRC Sec 179 deduction limit for 2001 is \$24,000**. Businesses are allowed to deduct the cost of certain equipment in the first year it is placed into service, rather than having to depreciate it over 5 or 7 years. This does not apply to most autos and to real estate. The equipment only needs to be placed into service by December 31st. You can purchase it with a credit card or business loan, and pay for it later, but get the deduction in 2001.

Individuals who may have medical expenses or miscellaneous itemized deductions should consider “bunching” these deductions in order to get past the annual AGI limitation. As with cash-basis businesses, these expenses charged on a general purpose credit card are deductible in the year they are charged, not when the credit card bill is paid.

Individuals who itemize their deductions and make estimated tax payments should consider paying the fourth installment of the state estimated taxes by December 31st to accelerate the deduction on the federal return to this year rather than next year.

Be sure to maximize your retirement contributions. Take advantage of any 401(k) plans sponsored by your employer. Maximize your Roth IRA contributions. If you are not eligible for a Roth IRA, maximize your traditional non-deductible IRA contribution. If you have a small business, explore your retirement plan options. Have your retirement plan reviewed by your attorney as soon as possible to determine which amendments need to be made and the possibility of adopting a safe-harbor 401(k) plan.

If you want to fund an Education IRA for your children, the year 2001 contribution is due by December 31, 2001.

Prepare for an Audit. No matter how careful or conservative you are, no matter how much care we take in preparing your return, there is always the chance that your return may be randomly selected for audit. The best defense is to plan ahead. You need a system to accumulate the data to prepare your return and you need to retain that data.

Whenever you have an expenditure that may be deductible, get a receipt. Set up envelopes for each category of tax deductible expense. Put the receipts for that category in the appropriate envelope. Make a notation in your checkbook for those items that are tax deductible. Keep your cancelled checks with your bank statement and keep these in a safe place. At the end of the year, list the checks for each category and cross-check the list with the receipts. Put the total spent on the envelope. These envelopes become the basis for your tax return.

An audit is merely a substantiation process. You have to prove your deductions. If your charity envelope has shows a total of \$500 in receipts and checks, and if that’s the number on the return, when you are asked to prove the \$500 deduction, all you have to do is produce the envelope and the cancelled checks.

