

Summer 2003 FINANCIAL NOTES

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Inside this Issue:

- New Tax Law Passes
- Planning for College Tuition
- Staff News

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They Did It !!! Passed A New Tax Law

By Harvey J. McCown, CPA

HIGHLIGHTS

- \$100,000 Write-Off of Equipment Purchases
- 50% Bonus Depreciation On New Equipment
- Automotive Vehicles
- Capital Gains 15%
- Dividends 15%
- Increased Child Credit
- Rate Bracket Expansions & Rate Reductions

\$100,000 EXPENSING OPTION

You can now write off \$100,000 per year of equipment purchased on or after January 1, 2003. Yes, this does apply to equipment you purchased five months ago and it now includes off-the-shelf software. This is the old \$25,000 amount for tangible personal property. This rule applies for the years 2003, 2004 and 2005. The total purchase limit has been increased from \$200,000 to \$400,000.

Planning Point – Consider purchases you may want to make during these three years. Consider your expected taxable income. Time the purchases to get the best reduction in your taxes.

50% DEPRECIATION

You can deduct 50% of the equipment cost as depreciation in the first year. This applies to purchases after May 5, 2003 and before January 1, 2005. The equipment must be new and have a depreciable life of 20 years or less. The cost must be reduced by any amounts deducted in the \$100,000 expensing option before computing the 50%. The balance of the cost (after the expensing option and the 50% deduction) is eligible for the regular depreciation deductions.

Planning Point – Consider your planned purchases and expected taxable income to maximize the tax benefit of these rules.

Planning Point – This write-off could put you in lower tax brackets for 2003 and higher brackets in the future. You do have the option to claim less depreciation in the first year – elect the 30% method or no bonus depreciation at all.

Planning Point – This 50% depreciation can be used to create a Net Operating Loss deduction and get a refund of taxes you paid in the previous two tax years.

Planning Point – The 50% rule only applies to the purchase of new equipment. This may hurt the used equipment prices. Consider purchasing used equipment if you cannot use the extra deductions.

AUTOMOTIVE VEHICLES

Vehicles have been a hot issue in the news. The key is the weight of the vehicle. The test is 6,000 lbs. unloaded gross vehicle weight. You can now deduct up to \$10,710 in the first year for vehicles under that weight (up from \$7,660).

You may be able to write-off the entire cost of a new luxury SUV! The above vehicle limit does not apply if the vehicle weighs more than 6,000 lbs. You can use both the \$100,000 expensing option and the 50% depreciation rule. Your actual deduction will be less if you do not use the vehicle entirely for business. Other purchases may also reduce your effective first year deduction.

(Continued on pg.2)

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Planning Point – *What a time to consider a purchase of a heavy (luxury) vehicle!*

Caution – *Congress is being severely criticized over the SUV issue. Might they change these rules and restrict the write-off for SUVs? California is also making noise about limiting write-offs for SUVs. Give us a call for the latest on these issues.*

CAPITAL GAINS – 15%

The tax rate on net long-term capital gains has dropped from 20% to 15% for sales after May 5, 2003. This rate continues through 2008 when it reverts to the 20% rate. Those in the 10% and 15% regular tax brackets see a drop to 5% through 2007, 0% in 2008 and back to 10% in 2009. These rates also apply for the alternative minimum tax calculations. Unfortunately this does not apply to collectibles and the unrecaptured 1250 gain.

Planning Point – *Consider your investment portfolio paper gains and losses. All the old offsetting techniques still apply. This 15% tax rate may make a sale worth considering.*

Caution — *Be careful when you consider selling business assets. Depreciation recapture, real property depreciation recapture, tax on unrecaptured section 1250 gains, and the tax on collectibles all have not been reduced to this rate.*

DIVIDENDS – 15%

Most dividends will be taxed at the capital gains rates described above. Dividends received before May 6 are also eligible for these lower rates. Qualifying dividends include dividends from domestic companies and from certain foreign corporations (including those traded on a U.S. exchange). These rates also apply for the alternative minimum tax calculations.

Planning Point – *Consider this change in taxation when evaluating your portfolio.*

Congress was concerned that taxpayers would get an unfair advantage with this lower dividend rate in conjunction with other tax provisions. This favorable treatment does not apply to dividends from regulated investment companies (some mutual funds), tax exempt organizations, farmers cooperatives, mutual savings banks, certain ESOP stocks, certain REITs, and some preferred stocks. The IRS will be issuing a new form 1099 to report qualifying dividends. Stocks held for less than 60 days (90 days for preferred) do not generate qualifying dividends. Dividends in excess of 10% of your basis (5% for preferreds) will be a qualifying dividend, but will cause the loss on sale of those shares to be treated as long-term capital losses (limited to the amount of the qualifying dividend). Fair

market value can be used for this test, if provable to the satisfaction of the Treasury.

Caution – *These rules are complex and not yet clear. Consider carefully any plan that seems to take undue advantage of the new dividend rule.*

INCREASED CHILD CREDIT

The child credit has been increased from \$600 to \$1,000 (for 2003 and 2004). Checks for the increase will be mailed starting July 25, 2003 (based on eligibility from the 2002 income tax return).

Planning Point – *Be sure to tell us of any children born or adopted during 2003. They will not be included in the refund the IRS will be sending out shortly. Also, bring us a copy of the check and the IRS letter notifying you of your refund so we can claim the balance of the credit on your 2003 income tax return.*

TAX BRACKET EXPANSION AND TAX RATE REDUCTIONS

The previous tax law change provided for reductions of the top tax brackets at various times in the future. Those reductions are now in effect for 2003. The brackets have been reduced from 27% to 25%, 30% to 28%, 35% to 33% and 38.6% to 35%.

Planning Point – *Many people will consider accelerating their taxable income to take advantage of these lower rates.*

Caution — *Long range tax planning is dependent on the tax rates. Consider the political chances of these rates staying the same or being changed. Also consider the chance of a change in the tax system. Any taxes paid early are most likely not going to be refunded in case of such a change.*

The 10% bracket has been expanded. That reduces the total tax for everyone in and above that bracket. The marriage tax penalty has been eliminated by expanding the 15% bracket for married filing jointly to twice the size of the 15% bracket for single returns, and the standard deduction has been increased to twice that for those filing single.

WITHHOLDING

The IRS has already released new withholding tables and urged them to be implemented immediately.

Planning Point – *Your employees will probably be asking for this reduction before you are ready to do the calculations.*

CONGRESS IS STILL IN SESSION - And may pass additional tax law changes before adjournment. Call us for an update on additional changes.

A Primer for Paying for College

With college tuition skyrocketing, many parents are interested in learning more about saving and paying for college. So, whether your child is still in diapers or already has completed his or her first semester, get out your pencil and take note of these education planning strategies.

As Soon as Possible

The first step in college planning is to establish a goal. You need to look at all the potential expenses that will be involved in your child's college education. College-related expenses begin even before your child is accepted into a school (think about testing fees, college visit costs, and application fees).

College expenses include more than just tuition. If your child goes away to school, there will be room, board, and spending money. A student living at home will have commuting expenses to and from campus. Add in student activity fees, lab fees, books, and special equipment (laptop computers, for example, for some schools), and these non-tuition expenses can really mount up.

If your child is still young, you need to consider what impact inflation will have on what you end up paying for college expenses.

While the general inflation rate has averaged about 3% for the past 20 years, the average college-cost inflation has been about double that figure. Using a 6% cost inflation rate, the College Board, a national nonprofit organization, estimates that a child born in 2003 could need \$160,000 to attend a public college for four years and \$346,000 for four years at a private institution.

Scary numbers, for sure. However, the College Board also reports that more than 60% of public college students — and more than 75% of private college students — receive some type of financial aid.

Below we summarize some of the steps you can take both before and after your child starts college to deal with the financial burdens of paying for a college education.

Before Your Child Starts College

Save with a Section 529 tuition plan. While contributions to these popular plans are not federal income-tax deductible, earnings from qualified state programs are now tax free, so more of your money will go towards tuition instead of taxes. And check out any state tax benefits that may result from contributing to your state's program. High earners should note there are no maximum income restrictions on Section 529 plan contributions.

Contribute to a Coverdell Education Savings Account (formerly called an Education IRA). The maximum annual contribution is \$2,000 per beneficiary if your and your spouse's combined adjusted gross income (AGI) is less than \$190,000.

(Continued on Pg. 4)

Staff News

Promotions to Senior Accountant



Shawn M. Canaday, CPA was recently promoted to Senior Accountant. Shawn has been with the firm for nearly two years and has been an integral part of the firm's audit division. He has been focusing his efforts towards the oil and gas business of the firm.



Matthew Gilligan was recently promoted to Senior Accountant. Matt has been with the firm for two years and has been focusing his efforts in the audit and tax divisions of the firm.



Patricia Welch, CPA was also recently promoted to Senior Accountant. Patricia has been with the audit division of the firm for two years.

Part-time AgStar Software Consultant

We are looking for a part-time AgStar software consultant to assist with software training.

Please send resume to: Deanna Blaise, Brown Armstrong CPAs, 4200 Truxtun Ave., Ste. 300, Bakersfield, CA 93309, fax (661) 324-4997 or by e-mail dblaise@barrcpa.com

Once Your Child Is in College

Take a tax deduction. In 2003, if your AGI is \$65,000 or less (\$130,000 for married couples filing joint returns), you may be able to take a deduction of up to \$3,000 per year for higher education costs.¹

Claim a tax credit. A Hope Scholarship Credit of up to \$1,500 a year may be available for the first two years your child is in college. Once you are no longer eligible for the Hope, the Lifetime Learning Credit provides a 20% credit on the first \$10,000 of qualified expenses. Income limitations apply.

Transfer college credits from a less expensive college to a more costly school. Many prestigious, and expensive, universities allow students to transfer credits from more affordable two-year programs and apply them to a four-year degree.

Tap into your IRA or 401(k). To pay for qualified higher education expenses, you can make penalty-free withdrawals from your Individual Retirement Account before age 59½. If your 401(k) retirement plan at work offers loans, you might consider borrowing from your 401(k) account for education costs. But be careful that you don't jeopardize your own retirement funding.

We Can Help

We can provide you with the information you need on the tax benefits available to you in your college financing. Moreover, we can help you develop a plan for meeting your education savings goals, no matter whether you have 18 years or 18 months to plan. Contact us soon.

¹ The higher education deduction can't be claimed for a student's expenses if the Hope Scholarship or Lifetime Learning Credit has been claimed with respect to the same student for that year.

FINANCIAL NOTES

