MID-YEAR 2004 TAX PLANNING MEMO

Tax planning should be a year round activity, not something done in December, or worse, in April. Of course, these landmarks in time - the end of the calendar year and the Income Tax filing deadline are, for most of us, the call to action that is often too late to really be effective. We are presenting this mid-year planning memo so it might call you to action now, earlier in the year - when you will have adequate time to fully plan and take appropriate action.

Many changes in our world also need to be illuminated. It seems that government, institutions of higher education and the stock market are constantly conspiring to "move the cheese." This memo will highlight some of the changes that may impact your tax planning as an individual, a business owner, or the parent of an aspiring college student. As always, please don't hesitate to call us with any questions you may have or to **heed this call to action.**

Tax Rates. The EGTRRA of 2001 and the JGTRRA of 2003 lowered the tax rates for nearly all individuals. Whether they will stay at the rates shown below will be the subject of national debate this fall. At the least, the lower rates for 2004 coupled with increased standard deductions, reduction of the marriage penalty and lowered capital gains tax may lower your tax liability this year.

2004 TAX RATES AND TAXABLE INCOME BRACKETS

Rate %	Single	Head of Household	Married Filing Jointly (Surviving Spouse)	Married Filing Separately
10	$0 – 7,150	$0 – 10,200	$0 – 14,300	$0 - 7,150
15	$7,150 – 29,050	$10,200 – 38,900	$14,300 – 58,100	$7,150 - 29,050
25	$29,050 – 70,350	$38,900 – 100,500	$58,100 – 117,250	$29,050 - 58,625
28	$70,350 – 146,750	$100,500 – 162,700	$117,250 – 178,650	$58,625 - 89,325
33	$146,750 – 319,100	$162,700 – 319,100	$178,650 – 319,100	$89,325 - 159,550
35	Over $319,100	Over $319,100	Over $319,100	Over $159,550

As you can see, the thresholds for the respective tax rates have increased slightly with the intention of countering inflation.

Capital Gains. Since the JGTRRA 2003, long-term capital gains incurred on or after May 6, 2003 are subject to new, lower tax rates. For taxpayers in the 25% tax bracket and higher (28%, 33% and 35% in 2004), the rate on long-term capital gains is reduced from 20% to 15% in 2003 through 2008. For taxpayers in the 15% and 10% brackets, the rate on long-term capital gains is reduced from 10% to 5% in 2003 through 2007, and all the way down to 0% in 2008. Additionally, "qualified dividend income" is now treated as capital gain and is subject to these lower tax rates.

Unless Congress enacts new legislation, these rates will hold through 2008. After December 31, 2008, the lower rates on long-term capital gains will "sunset" (expire), at which time the prior capital gain rates (20%, 10%) will, once again, be effective.

Retirement Plans. A long-range plan for sustaining a comfortable lifestyle in your retirement years starts with an estimate of income and expense during retirement. Your income will likely include amounts from investments, retirement plans, IRAs and Social Security benefits. We can help you with these preliminary calculations, if your estimated retirement income does not cover your anticipated expenses; you need to close the gap.

The maximum contribution to retirement plans increased in 2003 and for most plans again in 2004. If you are age 50 or older the catch-up contributions allowed are higher as well.

MAXIMUM PLAN CONTRIBUTION

Plan Type	2003	Age 50 or Over 2003	2004	Age 50 or Over 2004
Roth IRA	$3,000	$3,500	$3,000	$3,500
IRA	3,000	3,500	3,000	3,500
SEP	40,000	40,000	41,000	41,000
403(b) *employee*	12,000	14,000	13,000	16,000
Keogh	40,000	40,000	41,000	41,000
401(k) *employee and self-employed*	12,000	14,000	13,000	16,000
SIMPLE	8,000	9,000	9,000	10,500

The market may not have treated your IRA or 401(k) kindly over the past few years, but 2004 may be a good year to fund your tax favored plan to the maximum allowable level. Making the contributions earlier in the year will allow for more earnings growth.

Health Savings Accounts. It was easy to miss this small part of the Medicare reform that was signed into law in December. If you are self-employed, or a small business owner you may want to learn about Health Savings Accounts (HSA) that are now available for anyone under 65 who has a “high deductible” health care plan.

An HSA can be compared to an IRA for healthcare costs. Contributions are exempt from federal (and many state) income tax and funds grow with tax deferred interest. Withdrawals are tax free when used to pay out-of-pocket medical expenses. The account is portable – you can take it with you when you change employers – and withdrawals are penalty free after age 65. At death the account balance may be transferred tax free to a spouse.

Most of us will not qualify for an HSA. Your deductible must be at least $1,000 for an individual. However, if you do not now have medical coverage, or if your firm is struggling under the burden of relentlessly increasing health coverage costs, an HSA may be an important new strategy for you.

Estate Tax. Certainly we hope that you have many more years to plan for the disposition of your estate, but we will mention that this year more of your estate will escape the tax arm of the government. The estate tax exemption increases from $1 million to $1.5 million. With the value of your home and other assets this exemption is frequently surpassed and estate taxes can take as much as 48%. 2004 may be the year to initiate strategies that will protect this part of your legacy from the tax man.

Will deferral and state estate taxes truly disappear? They are scheduled to do so in 2010, but unless Congress acts, they will reappear in the following calendar year.

What does history tell us? The estate tax has been installed and removed five times. Every time Congress needs money, such as war or another economic crisis, it re-appears.

What does government budgeting tell us? A major component of the federal budget is interest on the national debt. Since that debt keeps growing, the interest problem continues to grow. When (not if) interest rates rise sharply, the debt service will soar – and this has been predicted as another major reason the federal estate tax will never truly disappear. It is politics – not Republican or Democrat – but the bureaucracy of the executive and congressional branches.

Business Depreciation. Changes that were initiated last year (as a result of JGTRRA) continue to offer businesses special depreciation deductions on equipment and computer purchases up to $400,000 and $100,000 the first year. The example here shows how a firm might benefit by writing off a major portion of the purchase of $150,000 of equipment placed into service in 2004.

BUSINESS DEPRECIATION	
Equipment Purchases = $150,000	
Expensing election	100,000
Additional first year depreciation (50% x $50,000 remaining adjusted basis)	25,000
Regular MACRS depreciation ($25,000 remaining adjusted basis)	5,000
Total 2004 write-off	$130,000
Assumes half year convention and MACRS five year recovery class	

Off the shelf computer software is now eligible Section 179 property. The maximum deduction for Section 179 property placed in service in 2003 or later is $100,000.

Business Mileage. The standard mileage for business travel allowed by the IRS has been changed to 37.5 cents per mile for 2004. This year the standard mileage may be used for up to four vehicles that you own or lease and use simultaneously. This may change your recordkeeping for 2004 if you operate a small fleet.

Financing a College Education. We've published the following chart before and the information hasn't become any less intimidating. It shows the amount that must be saved each year to accumulate $100,000 for a child's college education, assuming an interest rate of 8% compounded annually without any taxes applied.

ANNUAL SAVINGS REQUIRED TO ACCUMULATE $100,000		
If a child is:	**Years to Save:**	**Annual Savings Required:**
Newborn	18	$2,472
Age 3	15	$3,410
Age 8	10	$6,342
Age 13	5	$15,783
Age 16	2	$44,516

This is a hypothetical example only and does not reflect any specific investment. Both the return and principal value of investments will fluctuate over time. Source: WPI Communications.

While financing a child's college education is a daunting task, it's not insurmountable. To build up a fund for a college education, make saving for college a priority item on the budget, right along with paying the mortgage or meeting an insurance bill. What can you do about this funding problem?

> **Investigate Financial Aid.** While financial aid often is based on need, your child still may be eligible for some type of state or federal financial assistance. This can take the form of a grant, work-study program or a low-interest loan. Some types of investments are counted in the current Congressional Aid Formula while others are not. This varies based on ownership (parent, child or trust) and the form of property (savings, bonds, stocks, mutual funds, retirement accounts, annuities and life insurance).
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> **Investigate Tuition Programs.** Many state universities, as well as certain private schools, offer tuition prepayment plans or other variations. While a tuition plan might be beneficial, make sure you get all the details and understand how the plan works. Caution: There may be significant drawbacks to such an arrangement (e.g., no investment earnings received on prepaid amounts if the child does not attend a particular school). You may want to consider special "529" tuition plans that offer unique tax benefits, but naturally have some limitations.

Life Insurance Coverage. In light of certain changes in your life or lifestyle, it may make sense to either increase or decrease your current life insurance coverage. Perhaps there has been a birth, adoption, death, disability, divorce, marriage or other significant event in your family. Maybe you bought or sold a principal residence, vacation home or other real estate. Perhaps a family member switched jobs, retired or started a new business. Don't wait until the anniversary date to update insurance. Now might be a good time for us to help you review the status and options in all your insurance: life, disability, medical, long term care and your general liability coverage's.

Conclusion: The ideas discussed here should be reviewed with regard to your individual situation. It is not meant to constitute tax advice, so be sure to contact a professional tax or legal adviser when appropriate. We would be glad to schedule a meeting to assist you with a comprehensive mid-year plan that meets all of your objectives: Just give us a call….