2003 Article

Income Tax Filing Highlights

Interpreting Changes

TIS' THE SEASON!

Virtually all Michigan tax-paying families are pleasantly surprised by changes to the federal and state income tax pro- visions and find they are paying less taxes in comparison with prior years. Increased personal exemptions at both the federal and state level, lower graduated tax brackets (federal), flat tax rate (state) and new line item deductions find many taxpayers benefiting significantly. Let's focus on some of the more generic changes that affect the majority of filers.

TAX BRACKETS

The new 10% tax bracket on the first $12,000 of taxable income has saved married couples $600. This year the 15% bracket remains unchanged, however the next marginal tax brackets of 27%, 30% and 35% are a full percentage point lower than the levels prior to the tax act of 2001.

TAX CREDITS

Income level phaseouts are increased for popular credits such as child (up to $600 per child under age 17), adoption (up to $10,000 credit on qualified expenses), earned income (up to $4,140 for 2 children, subject to earned income/adjusted gross income considerations) and child care (up to $600 per child, on qualifying day care expenses).

EDUCATION CREDIT AND DEDUCTIONS

The hope scholarship (maximum $1,500) and lifetime learning credit (maximum of $1,000) provide relief to parents with dependent children attending college. Student loan interest is now deductible beyond the previous limitation of 60 months. College tuition deduction is a new tax law provision for 2002, however the deduction cannot be taken if credits (which are usually more beneficial) are taken on the same tuition expenses. Adjusted gross income phaseout levels are indexed for inflation annually, but many medium and high income taxpayers will be disappointed when these education provisions are not available.

RETIREMENT ACCOUNTS

Increased contributions are allowed for IRA (Traditional, Roth, and Coverdell, or Education), 40 I (k), 403(b), SEP IRA, etc. Individuals 50 and over are allowed addition- al contributions depending on the account type. Minimum distributions for account holders age 70 and over have been lowered and extended to reflect longer age expectancy. Financial planners and CPAs need to work together to ensure that proper planning is performed in this critical area of personal investment.

MISCELLANEOUS DEDUCTIONS

Teachers may now deduct up to $250 in classroom supplies as an adjustment to income on page 1 of the 1040. This means that the deduction will carry over to the state tax return and thus save an additional $10. Other unreimbursed employee expenses (mileage, etc), union dues, tax return preparation fees, safe deposit box rental, investment fees, etc. are still deductible on schedule A, limited by 2% of adjusted gross income. Self employed individuals may now deduct 70% of their health insurance premiums on page I of the 1040 (100% in 2003) with the balance deducted with other medical expenses on schedule A, limited by 7.5% of adjusted gross income. 2002 mileage rate allowances for business, medical/moving and charitable are 36, 13 and 14 cents, respectfully. Other deductions such as vehicle license tabs, non cash charitable contributions and gambling losses are frequently omitted by taxpayers and should be considered when compiling year end tax material.

STATE TAX PROVISIONS

Michigan taxpayers will enjoy a higher personal exemption ($3,000, plus $1,900 for age 65 and older, blind or disabled and $600 per child age 18 and younger), lower flat tax rate (4.1%) and incentives for state funded section 529 education plan investments (up to $10,000 deduction and possible state matching fund contribution). Many taxpayers neglect to claim public contributions, community foundations, and homeless shelter/food bank credits on the state income tax return. Even non-itemizing individuals can receive up to $200 for each of those three categories (50% of actual contribution) . Renters may qualify for a homestead property tax credit if 20% of annual rent paid exceeds 3.5% of household income. This provision affords renters a similar credit that homeowners have always enjoyed, if household income is less than $83,650. Seniors are pleasantly surprised to find that social security, pension and IRA/40l(k) distributions are exempt from state income tax and that investment income up to $16,545 may be excluded from income if they have no pension.

The tax filing season may bring challenges in interpreting recent tax law changes. Taxation in not an exact science and therefore not always as clear as black and white. Congress writes the bills that become law and the IRS interprets those laws by their reasoning methodology. It is important that taxpayers seek professional guidance in getting through the dreaded task of tax filing, but also seek proper consultation on 2003 and future. As always, I welcome your thoughts, questions and comments.

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