

November 15, 2002

Dear Clients and Friends,

This has been a year of uncertainty —uncertainty about the stock market, uncertainty about the economy, and uncertainty about what new tax laws Congress might pass.

This year over 400 changes from the 2001 Tax Act took effect. Congress passed an economic stimulus law with tax breaks for teachers and businesses. Congress tried, but was unable to pass legislation to permanently repeal the estate tax. As the year winds down you will want to watch for any additional tax revision Congress squeezes into 2002.

In an environment of constant change it is very important that you make time to do tax and estate planning. Whatever happens in the stock market, the economy, or in Washington, you will find that a tax planning session is one of the smartest moves you can make to improve your own financial situation and that of your family.

Aim For Lower Taxes In 2002 And Beyond With Smart Year-End Moves

According to the Tax Foundation the average American works over a third of the year just to pay taxes. Fortunately, year-end tax planning can help you end up with a lower tax bill for 2002 and give you a head start on tax savings for 2003. As the year draws to a close take time to investigate moves that can cut your taxes.

Minimizing your taxes requires a twofold strategy: long-range planning and an annual year-end review for fine-tuning. For best results prepare a two-year income tax projection for 2002 and 2003. You will need to know your tax bracket for both years and to be generally aware of the current tax rules in order to make good year-end tax decisions.

Retirement planning

You can contribute more to your retirement accounts for 2002 and if you are 50 or older, you can even make catch-up contributions. If you are covered under a 401(k) or SIMPLE

plan at work ask your employer whether you can make additional contributions before year-end. Contributing to a retirement plan shelters your current income from taxes and your investment grows tax-deferred, or in some cases tax-free.

For 2002 you can contribute up to \$3,000 to an IRA (\$3,500 if you are 50 or older). The 401(k) contribution limit is \$11,000 (\$12,000 if you are 50 or older). The limit for SIMPLE plans is \$7,000 (\$7,500 if you are 50 or older).

Though you have until April 15, 2003, to make your 2002 IRA contribution, the earlier you contribute the longer your money can grow tax-free. Be aware that you can also contribute to a spousal IRA for your nonworking spouse.

If you are over 70½, you generally must take a minimum distribution from your IRA and other retirement accounts, such as a 401(k) plan, by December 31. By taking the required distribution on time you can avoid a 50% penalty.

Education tax planning

To take full advantage of education tax credits and deductions you might need to adjust year-end payments. For 2002, you may be able to deduct up to \$3,000 of college expenses and up to \$2,500 of student loan interest. You could also qualify for up to a \$1,500 Hope tax credit or a \$1,000 lifetime learning credit.

Home tax planning

Are you in the process of buying a home or refinancing your mortgage? If so, you might be able to deduct some or all of the points paid. We suggest you finalize the loan before year-end to speed up deductions.

If you are thinking of selling your home before the end of the year, it is good planning to calculate your likely gain and determine whether you will qualify for the gain exclusion of up to \$250,000 (\$500,000 for married couples). Planning is especially important if you have rented your home or used a portion of your home for business.

Investment planning

Perhaps it is time to rebalance your portfolio or sell under-performers. If you plan to sell investments by year-end, keep the following in mind.

Selling investments inside your retirement accounts will not trigger taxes. If you sell investments that you hold outside a retirement plan the taxman will want his share.

Whenever possible take advantage of long-term capital gain rates which are lower than regular income tax rates. You can do this by holding an investment for more than a year before you sell it.

If you have racked up stock losses outside your retirement accounts this year consider selling some winners by December 31 to offset those losses. These gains will be entirely tax-free to the extent of your losses. You can immediately repurchase your profitable securities if you wish to do so. Consider transaction fees in deciding whether this strategy makes sense for you.

Other year-end ideas

Did you know that over 20 tax breaks phase out once your income reaches certain levels? An essential part of tax planning is being aware of the income thresholds that affect you. If your projected income is only slightly above the limit for one of these tax benefits you may be able to control the timing of year-end income or deductions and still qualify for the break.

There are several ways to move income and deductions from one year to another. For example, you might squeeze extra deductions into 2002 by paying medical bills and property taxes this year instead of waiting until 2003.

One way to postpone income is by selling an investment on the installment method instead of a cash contract. Or you could postpone selling an investment until 2003 so the gain will be taxed next year.

Family Tax Planning-Use Family Ties To Trim Your Taxes

Few areas offer as much scope for creative tax planning as our family relationships. From parents and grandparents to children there are opportunities to reduce taxes and keep more of what you earn. Consider these ideas.

Parents

Are you or your siblings supporting an elderly parent who is not in good physical or financial health? If so, a year-end review can help you maximize the tax breaks.

You may be able to claim your parent as a dependent, giving you an extra exemption worth \$3,000. If you are single and supporting a parent you may qualify to file as head of household and reduce your taxes. To qualify you generally must provide more than half your parent's support for the year and meet several other tests.

You may also be able to deduct your parent s medical expenses as well as your own. If you pay for someone to care for your parent while you work look into the dependent care credit.

Grandparents

On the other hand, your parents might be financially secure and interested in reducing their taxable estate by supporting a grandchild s education. In that case, they could look into an annual gift program, making tax-free gifts of up to \$11,000 each (\$22,000 for joint gifts) to as many individuals as they want. They can contribute to education savings plans set up for their grandchildren. If they set up a Section 529 plan they could contribute \$55,000 each (\$110,000 for joint gifts) for each grandchild.

Children

Funding your children s education may be a top priority, one that offers a number of tax-cutting opportunities.

If your children are not yet in college, look into Section 529 college savings plans which offer income and estate tax-advantaged savings (see above). You may also wish to check out Coverdell education savings accounts (formerly called education IRAs), which were improved in last year s tax law.

If you or your child is already in college, check out the Hope and lifetime learning credits, the new education deduction for higher education expenses, and the student loan interest deduction.

Tax savings are possible if you can shift income from you to your children who pay taxes at lower rates. Opportunities are limited for children under age 14 because of the kiddie tax.

Strategies for shifting income include transferring income-producing investments to your children or employing them in your family business. You might also be able to reduce the 20% capital gains tax rate to 8% by transferring an investment to your child before selling it.

Investment Tax Tips

As year-end approaches it is time to review and rebalance your investment portfolio. Although 2002 was a disastrous year for many investors, you can still make some smart moves to reduce taxes if you are selling stocks or mutual funds.

First, remember that any sales you make within your retirement accounts are free of tax. If you need to trade just to rebalance your portfolio consider doing it in your IRA or 401(k) plan.

If you are selling investments to weed out poor performers, remember that losses can cut your tax bill. You can use capital losses to offset taxable gains plus up to \$3,000 of other income. If you still have losses left over, you can carry them forward to use in future years.

You can often manage the size of your gain or loss when you decide to sell some, but not all, of a particular stock or mutual fund. To do this, you must have kept good records of the date and the price for each share purchase. By selling the highest cost shares first, you will minimize your taxable gain or maximize your loss. You must specify the particular shares you are selling at the time you sell.

If you are planning to sell mutual fund shares close to year-end try to do so before the fund declares its annual taxable distribution. Many funds do this in December, so confirm the exact date with the fund manager.

If you want to dispose of stock that has appreciated, consider donating it to your favorite charity. You can generally claim a deduction for the appreciated value and avoid paying any tax on your gain.

Tax Cutting Strategies For Your Business

For most businesses, December 31 marks the deadline to reduce your 2002 tax bill. Consider the following year-end strategies to cut your business taxes.

A retirement plan can reduce your tax bill and build a nest egg. If you plan to set up a 401(k) or Keogh plan for 2002, the deadline for doing so is December 31. Company contributions can be made as late as the due date for filing your tax return, including extensions.

New rules allow more businesses to use the cash method of accounting. If you are using the accrual method, find out whether your business might benefit from switching to the cash method and what year-end moves you should make.

If you plan to sell business property and replace it with similar property, check into a tax-deferred exchange. An exchange may allow you to trade up in value without owing tax.

Shifting income is a tax strategy that people in business often find useful. For example, if your earnings are approaching the \$84,900 social security limit this year; consider accelerating other income into 2002 so those earnings can escape social security tax. You will pay income tax sooner, but you will have permanent savings from social security tax.

The legal form your business operates under can have a significant effect on the taxes you will pay and your costs of doing business. If you have not done so recently, it may be a good idea to review your legal form to see if it is still the best choice.

As a business owner, you should stay alert to ways you can structure your affairs to gain tax breaks. For example, if you plan your year-end vacation to combine business with pleasure, you might be able to deduct part of your travel costs.

If your business needs new computers or equipment consider buying them before year-end to take advantage of bonus depreciation. This new tax break amounts to an extra 30% first-year depreciation deduction for most new property except buildings.

Looking Ahead To 2003

There are more tax changes coming in 2003. Keep these in mind as you do your tax planning.

If you are self-employed, the deduction for health insurance premiums increases from 70% to 100%.

The Section 179 expensing limit for business equipment purchases increases to \$25,000 for 2003.

Starting in 2003, a \$10,000 tax credit is allowed for adopting a special needs child even if you do not incur qualified adoption expenses.

The dependent care credit is expanded. The maximum credit increases from 30% to 35%. The maximum amount of expenses that qualify for the credit is \$3,000 for one child and \$6,000 for two or more children.

For the first time employers can permit employees to have separate IRA accounts within the company's qualified retirement plan. These deemed IRAs can be either traditional or Roth IRAs

Property Owners (Cost Segregation)

Do you own business real estate or rental real estate? As a result of a 2001 IRS ruling there is an opportunity to significantly increase depreciation expense and deduct some catch-up depreciation. Any building, leasehold improvement or renovation that was acquired after 12/31/86 can segregate its costs between real estate and personal property. Personal property can be depreciated over periods ranging from 5 years to 15 years, whereas real estate must be depreciated over 27.5 years or 39 years. The ability to segregate part of the cost, as personal property could be substantially advantageous. The IRS will accept such segregation if a Cost Segregation Study is performed using an engineering approach. Call us if you would like to discuss this prospect.

Estate Planning

A major family concern is how to transfer your wealth to the next generation at the least tax cost. Last year's tax law reduced estate taxes but did not eliminate them except for one year in 2010. Updated estate planning is more important than ever. Look into the many tax-saving techniques that are available, ranging from trusts to lifetime gift programs to insurance to forming Family Limited Partnerships or Limited Liability Companies.

Year-end is the perfect time to review your estate plan. The top tax rate dropped to 50% this year and it drops to 49% for 2003. The estate exemption amount increased from \$675,000 to \$1 million for 2002 and 2003. But the reality is that high estate taxes still exist. You may need to take action to minimize estate taxes and protect your family.

Outdated language in your will or other planning documents may prevent your estate from taking advantage of the changing rates and exemption amounts. You should also review your beneficiary choices on retirement accounts and life insurance policies to make sure they are still appropriate, considering changes in your life and the ever-changing tax law.

To reduce your taxable estate consider making gifts to family members by December 31. For 2002, you can give away up to \$11,000 to as many people as you want without owing gift tax. To count toward the current year's annual gift tax exclusion, gifts must be completed by December 31, so plan accordingly. For instance, your checks must actually

be deposited or cashed and stock transfers must be accomplished no later than December 31.

Income tax planning for you and your entire family can be challenging, but rewarding. Estate tax planning can give you a large return on your investment. The easiest question to answer is: Should I leave my assets to my family or to Uncle Sam? Call us for details or assistance.

This Annual Tax Planning Letter is being sent to encourage you to utilize all the opportunities the tax law provides to minimize your taxes. Whether you are an individual, an investor, or a business owner, taxes are one of your major expenses. A year-end income and estate tax planning review will help you organize your records and give you time to implement tax reduction strategies for 2002 before it is too late. Contact our office for assistance with your tax cutting efforts.

If you have questions about anything in this letter or if you would like to get together to discuss income and estate tax cutting options, please call us.

Sincerely,

Sharff, Wittmer, Kurtz & Jackson, P.A.