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New tax law client letter

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NEW TAX LAW CLIENT LETTER

To Our Clients:

On August 10, 1993, the 1993 Revenue Reconciliation Act was signed into law. The tax law changes in this act affect a broad range of individuals, particularly upper-income taxpayers and retired people. This letter summarizes the tax law changes that affect individuals. It tells you what the most important changes are, how your tax bill might be affected, and what you might be able to do about it. The letter discusses only the <u>federal</u> tax law, and does not take into account your state tax bill. (Caution: The planning strategies we discuss are <u>general</u>; since each client's situation is different, no specific strategy should be implemented without professional tax advice.)

<u>Two new higher rates--effective January 1, '93</u>. Here are details on the two new income tax rates: A new rate bracket of 36% applies to married couples with taxable income over $140,000, singles over $115,000, and heads of household over $127,500. For singles, marrieds, and heads of household with taxable income over $250,000, there is a new rate bracket of 39.6%. <u>Note</u> that the top rate on <u>capital gains</u> is still 28%--capital gains are not affected by the new top rates.

The so-called <u>marriage penalty</u>--when certain married couples with two incomes pay higher taxes than two singles with the same incomes--is higher under the new rate structure if the couple is in the 39.6% bracket.

Taxpayers can make a special election to pay <u>extra</u> '93 tax caused by the higher rates in three installments--due April '94, April '95, and April '96.

<u>General planning strategies</u>. Higher income individuals might want to invest in vehicles that produce capital gains or tax-exempt income. The spread between the top rate for capital gains (28%) and the top rate for ordinary income (39.6%) is 11.6 points; therefore, capital gains have become attractive for tax purposes. Deductions and deferral of income are now more valuable to taxpayers in the upper brackets. Therefore, taxpayers should consider making the maximum contribution to a 401(k) plan ($8,994) during '93.

<u>Note</u>: A new-law change in the rules on how much annual compensation may be taken into account in determining benefits and allocations under qualified retirement plans may affect executives making over $150,000. The change is effective after '93.

<u>No more cap on Medicare payroll tax</u>. Effective January 1, '94, earnings over $135,000 will be subject to the Medicare portion of the Social Security tax. The Medicare tax is 1.45%

each for employers and employees, and 2.9% for self-employeds. Without the cap, payroll or self-employment taxes for taxpayers with earnings over $135,000 will increase in '94.

More Social Security benefits are now taxed. Effective in '94, taxpayers with a certain income level will have to pay tax on up to 85% of their Social Security benefits. The formula is somewhat complicated, so we haven't included it here.

Estimated taxes made simpler. To avoid the underpayment penalty, individuals now have simpler rules to follow. After '93, they can pay (1) 100% of last year's tax if last year's adjusted gross income was $150,000 or less; (2) 110% of last year's tax (no matter what last year's AGI was); OR (3) 90% of the current year's tax (as under old law). Note: Underpayment penalties due to changes made by the new tax law are waived for '93.

Deductions. This is nearly all bad news for the taxpayer.

Itemized deductions are limited for taxpayers with adjusted gross income over $108,450 ('93 joint-filers' figure) and personal exemptions are limited for taxpayers with AGI over $162,700 ('93 joint-filers' figure). These cutbacks were set to expire in '96; now they've been made permanent.

Moving expense deductions have been cut back. For expenses incurred after '93, the following are no longer deductible: meals, closing costs, house-hunting trips, and temporary lodging in the new location. Also, the mileage needed to qualify for a moving expense deduction is increased from 35 to 50 miles.

For charitable donations after '93, no donation of $250 or more can be deducted unless the taxpayer has written substantiation--i.e., a receipt--from the organization. Taxpayers have until the return filing date, including extensions, to get the substantiation. A canceled check is no longer enough.

On the plus side, contributions of appreciated property to charity no longer create an alternative minimum tax "preference." This valuable tax break, which had expired, has now been made permanent. Further, it was expanded to include real and intangible property, in addition to tangible personal property. (Note that corporate contributions are also excluded under the act.)

The amount of deductible business meals and entertainment expenses has been reduced from 80% to 50%, effective after '93.

Club dues are no longer deductible after '93.

Also on the plus side, the health insurance deduction for self-employeds has been restored, until the end of '93. The deduction is generally 25% of health insurance costs.

Luxury tax repeal. Did you buy a boat, aircraft, fur, or piece of jewelry during '93? The new tax law repeals the 10% excise tax on such items, effective January 1, '93. Taxpayers who paid this luxury tax in 1993 should consider seeking a refund. The new law keeps the excise tax on luxury autos.

Do you have questions on how the new tax rules affect your tax bill and income tax planning moves? Please call our firm.

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