S. Miller

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As a member of the American Institute of Certified Public Accountants, (AICPA), Marc serves on the executive committee of the AICPA’s personal financial planning division. He is also a board member on the New York State Society of CPA’s personal
financial planning division. We are pleased to have Marc here to speak to us today. Marc--

M. Minker

Thank you. It’s always nice to hear somebody else read through my bio. It makes it sound that much more impressive. I wanted to take some time and get this kicked off so we have some framework within which we can all understand the discussion that we’re really going to focus on, which is the tax side of things.

Before I do, I wanted to spend a moment to pick up on a theme that Jane mentioned and that is dealing with financial literacy. Financial literacy is a big focus within the financial planning community, specifically within the American Institute of CPAs and the PFS practitioners that practice personal financial planning. I think it’s important that everyone recognize that there are more and more resources that are available to help people understand and manage their personal finances. In fact, with the prevalence of the Internet, I think it’s fair to say there is almost an overwhelming amount of information out there and I find, at least on my own, that I’m always looking for authoritative sources that I can get good information from rather than rehashed or edited information.
So before I go into some of the material, I wanted to share some of
the Web sites and resources I think would be useful not only as a
context and look back on the stuff we’ll cover this afternoon but
also on a general basis, on a go forward level to be able to find
materials that may be germane to other topics that are going to be
discussed in future conferences.

The three sites I’ll refer to I go to quite often. They are
www.aicpa.org/pfp for personal financial planning. It’s a very
good and robust site. The second one is the IRS site, www.irs.gov,
which has a wealth of forms, publications and other consumer
information that people would find very helpful, especially in the
tax context. Finally, one I’ll refer to often and one I think people
would get a lot of value from is the 360 degrees of financial
literacy site, which is at www.360financialliteracy.org. It is a
public service site that is supported by various corporate non-profit
organizations, including the AICPA, and on the site you’ll find
some very useful resources, some of which we’ll review and I’ve
used in some of the materials we’re going to cover today.

Finally, through the conference I’ve gotten involved in today, I had
an opportunity to look in the Wi$e Up Women site, which is at
www.wiseupwomen.org, and I find that to have some extremely
useful links and other resources that I think people can get very good value from.

What are we going to talk about? First of all, we want to put a context for today’s discussion. Obviously, the focus is going to be on taxation and retirement savings, and I wanted to give you a framework within which to think about that. Financial literacy, which was my opening comment, to me really means the ability to effectively evaluate and manage one’s finances in order to make prudent financial decisions. In order to accomplish this, I believe that people need to have an understanding of money, cash flow and at least basic economic and financial concepts.

There are five key areas of personal finance that I think are important for people to achieve financial literacy—money and income and understanding what they are, money management and cash flow management, spending and debt, savings and investments and, obviously, tax management.

When we talk about taxes in particular, I wanted to share a story I harken back to when I first started practicing 20-odd years ago. The story I’ll relate is a story of a fella Erv and his wife Beatrice who started what ultimately became one of the largest
manufacturing and garment companies in the country. I, as a new CPA and tax advisor, used to sit with Erv and go through his year end tax planning. I remember a comment he made, and he was probably 76 years old at the time and I was probably a 22 or 23 year old tax practitioner. He looked me in the eye and said, “I never, ever make a decision just for the tax benefits, and I don’t let the tax tail wag the economic dog.”

That comment and that story has kept with me throughout my career and really is one I believe is important to understand because it’s certainly impactful from a tax perspective to understand what the rules are, how to apply them, but certainly not to necessarily do things just for the specific tax benefits. I think we have to always bring ourselves back to what is the overall economic impact of a decision one would make, taking into account the tax benefits or implications and trying to figure out a way of structuring one’s life or finances in a way to best take advantage of the current laws.

Some of the things we want to go over today which really transcend tax planning but financial planning in general include understanding what your goals are, what the tools are that are available to you, and then trying to put a plan together that you
could put into action. The best way for me to think about this in a lay person’s context is to draw a parallel to building a home. Some of us may have the ability to understand what it’s going to take to excavate a site, put a foundation in, put the frameworks together, put the wallboard up and plumbing in. Others of us are going to have to look to somebody such as a general contractor or an architect.

In the context of tax planning, you have to decide whether you are a do-it-yourselfer or if there is some professional or other types of resources you may want to take advantage of in order to best plan for your particular tax situation.

On the tax planning side of things, there are basically two goals that I have come across in my years in practicing in the tax and individual financial planning arena. Tax goal number one is obviously to minimize the taxes, and number two is to make a decision as to whether or not we’re going to pay now on a tax bill or later. Not that you have a choice, but depending upon how things are structured, you may have an opportunity to defer taxes until a later point in time.
Currently tax rates, at least at the federal level, and I’m not sure what the representation is geographically at a state level, so I’m going to focus on the federal side, tax rates are ranging anywhere from 15% of taxable income to up to 35% of taxable income. I think it’s important to understand the definition of taxable income. People are probably pretty familiar with either a form 1040EZ, 1040A or a standard 1040 form. If you look at the form, you’ll notice there are different lines for things such as wages, interest and dividend income or what we call investment income, other types of income, some deductions from them which we call deductions off of AGI or to get to AGI or adjusted gross income, and finally, the ability to either take a standard deduction or an itemized deduction in arriving at one’s taxable income, which is what the tax rates are ultimately applied to.

When we’re talking about tax planning, there are a couple of things to consider. First of all, there are some techniques which our other speaker Gavin will cover that give somebody the ability to remove a portion of their income on a current basis from the gross income line by contributing, for example, to a 401(k) plan or a qualified retirement plan.
There are other techniques we’ll also get into that talk about
deductions, such as deducting state and local income taxes or
potentially sales tax, which is a new deduction that just came on as
part of the new tax law. So understanding what really goes into
defining and getting to a taxable income number is certainly the
first step in understanding the overall framework of tax planning.
There are some basics.

Number one. Postponing income recognition to minimize current
tax liabilities is extremely important. It allows you to invest more
now due to the tax savings and, to the extent that you’re investing
in certain retirement plans, you can certainly accumulate additional
funds for the future when potentially you might be in an overall
lower tax bracket.

Another technique I found quite useful is the ability to shift income
to lower tax bracket people. I mentioned before that the current
tax rates range from 15% to 35%; however there are a couple of
exceptions. Specifically, if you have children, you may have the
ability to shelter a little bit more income or at least expose income
to a lower tax rate. What I’m talking about is the ability to utilize
the kiddy tax rules in place for children under 14, as well as the
general tax rules for children over 14 but otherwise are not working.

The rules as they currently stand allow a child to have up to $800 of investment or non-earned income and not pay any current federal tax on that. So the first $800 of interest income or dividend income that a child might have would escape taxation in total.

In addition, the next $800 of income that a child might have would be taxed at a rate of no more than 15% so that you have an ability, on an overall basis, assuming you had sufficient funds, to be able to invest monies, generate approximately $1600 worth of interest, dividend or other type of investment income and effectively pay an overall income tax rate of about 7.5% federally. When you compare that 7.5% rate of tax to, let’s say, a 15%, 20%, 25%, 35% rate of tax, you start to see there is an ability to reduce the family’s overall tax burden and, as a result, create additional funds for future investment or for other types of consumption. I think that’s a very important thing to understand and know.

Another thing to consider is that the planning and timing of deductions is important vis-à-vis maximizing tax benefits. I mentioned the calculation of taxable income, after you’ve gotten to
the adjusted gross income level, is really dependent upon whether you have itemized deductions or if you’re able to take the standard deduction. In 2004, the standard deduction, which is a blanket amount the tax code allows tax payers to take irrespective of deductible items they might have, were as follows.

For married filing jointly, meaning a couple filing together, they’re able to exclude $9,700 dollars or take a standard deduction of $9,700. If an individual were married filing separately, that amount from a standard deduction perspective is $4,850. On the other hand, if one were the head of household, meaning a single parent with some children, a standard deduction is $7,150. Finally, if someone is single and has no children or other dependents, then that standard deduction is $4,850. It’s projected that for 2005, the current year, the standard deductions will be as follows: Married filing jointly, $10,000; married filing separately, $5,000; head of household at $7,300 and single filers at $5,000. Now that is projected, it’s not yet legislated or indicated by the IRS. But that’s what we think those numbers are going to be.

So the question now is why is that important and what does that mean for me as a participant and a listener? Those standard deduction amounts are important because if somebody were to
have deductible items such as mortgage interest, real estate taxes, state and local taxes, charitable deductions, miscellaneous deductions, job hunting expenses - which were mentioned earlier - that in the aggregate exceed those standard deduction amounts, then you have a benefit you’re able to take advantage of at the federal level by deducting effectively the higher of the itemized deduction amount or the standard deduction amount.

So one of the techniques and planning ideas here is if you’re kind of on the cusp, just above or below the standard deduction amount versus your itemized deduction amount, it may make sense to try to lump or group certain of these deductions into a year that you could really push that itemized deduction level up significantly beyond the standard deduction amount. How do you do that? A couple of ideas--

Certainly, to the extent that you are charitably inclined and are making charitable contributions and are at that level where you’re just about equal with the standard deduction, it may make sense to defer current year contributions into the following year. As an example, now we’re in 2005 and that’s why I think the comment that Jane made about planning ahead is so important. Look at 2005, take a look at what kind of charitable contributions you are
planning on making during the year, whether they come up on an aggregate basis to these standard deduction amounts, and if there is an opportunity to lump these and get a much larger aggregate itemized deduction amount in 06, consider maybe deferring some of your charitable contributions into the following year so that you’re able to get over that threshold. That’s one idea.

The other is if you are homeowner and have the ability to either accelerate into 2005 or defer into 2006 for the same reasons, your real estate tax payments. Obviously, you have to be careful not to go beyond the collection date because you don’t want the municipality coming back and saying we’re going to close out the house because you haven’t paid your real estate taxes. Nonetheless, to the extent that you have the ability to time this a bit, you may find you’re able to accelerate into a current year or defer into a following year and through that process, allow yourself to get a higher tax benefit on an overall basis.

The only way to do those kinds of things is to plan ahead. You cannot, in April of the following year, decide that maybe you should have put the deduction in the prior year. It’s too late. That’s why the plan ahead mantra or skill is such an important thing for somebody to do.
Another thing to consider with respect to itemized deductions--we talked a little bit about miscellaneous itemized deductions--recognize that, to the extent that you have miscellaneous itemized deductions, there is a threshold. In order to have a deductible miscellaneous deduction, your miscellaneous itemized deductions, things like job hunting expenses, tax preparation fees, investment advisory fees, things of this nature, are only deductible to the extent that they exceed 2% of your adjusted gross income.

In addition, if you happen to have a very large income, there is another phase out for itemized deductions called the 3% rule. If you are single and your adjusted gross income is $71,350 or more in 2004, then you start to and must reduce your itemized deductions by 3% of the difference between your adjusted gross income and that $71,000 number. For every other type of filer—married filing jointly or separate, head of household, etc.—that threshold was $142,700. So there is another factor to think about with respect to planning and whether or not it makes sense to defer or accelerate deductions and, for that matter, income into a particular year.
Another thing I wanted to touch upon is when you’re looking at your return—again, I don’t know how many have completed their returns as of April 15th versus put them on extension—to the extent that you have a large overpayment, it may make sense to consider adjusting your withholding. How does one do that?

There are a couple of calculators. I mentioned the 360 degrees financial literacy site. There is actually a tax calculator on there that will assist you in figuring out the proper amount of withholding one should have. If you find you are consistently over-withholding on your taxes, you’re getting large refunds when you file your return, you may want to consider filing a new W-4 form with your employer to reduce the amount of withholding and at the same time allow yourself some additional cash flow on a current basis in your net pay. Or to maybe use that additional cash flow through the lower withholding to fund additional contributions into an employer-sponsored 401(k) plan or other types of defined contribution plan or retirement vehicle.

A couple of other things I want to get to, some changes in the tax law and some overlooked deductions because those were some things that I think people had some questions or interest in. Before
I get to that, I wanted to talk about a couple things with respect to tax credits.

There are a number of tax credits available that, quite honestly, a lot of tax payers overlook. Let me name a few. Before I go down this road, let me state that a tax credit in many respects is a lot more valuable than a deduction because a credit is a dollar for dollar reduction of the tax, whereas an itemized deduction, as an example, is really only a marginal reduction in tax. A dollar credit is worth a dollar savings on tax. A dollar deduction is only worth between $0.15 and $0.35 in terms of tax savings. So you have to think about where you’re able to take credits and try to reduce your overall income tax liability.

Some of the credits we find are very common include the child and dependent care credit which allows you to deduct up to 35% of qualifying expenses for child care if you child is 13 or younger or is disabled. You’re limited to a $3,000 credit for one dependent or $6,000 for two or more, and there are some income limitations that apply.

In addition, there is a child tax credit which allows you to deduct up to $1,000 per child under 17 in 2004. There are limits of
income for availability of that tax credit. For married filing jointly, it’s $110,000 limitation on income, for married filing separately it’s $55,000. For all others, it’s $75,000 of income. So if your income is below those levels and you have children, you’re able to take a tax credit on your return. To the extent that you exceed those limits, there is a phase out that applies and a formula if you look at the IRS.gov site that will walk you through how to figure out what that is, or certainly the instructions for the 1040 form.

There are other credits for earned income. Education credits which are very vast and I’ll spend a moment on include the Hope and Lifetime Learning credit. You can take one or the other, but not both. The Hope credit provides you a maximum of $1500 per year in tax credits per student. The student, however, must be either in the first or second year of undergraduate study and has to be going to school at least half time. The Lifetime Learning credit is a $2000 per year credit and is available to any college or graduate school or continuing education. So even you as a tax payer, if you’re working and taking continuing education courses, may qualify for that credit. The main difference between the two credits is the total limit, $1500 at the Hope credit and $2000 for the Lifetime Learning credit.
Other credits for you to be aware of, the adoption credit, there is a credit for elderly or disabled individuals, a foreign tax credit to the extent that you might have investments in foreign companies that have dividends or withholdings on those dividends or other income. You’re able to take a credit on your tax return for that foreign tax. That’s another one of those overlooked items which we’ll get to in a minute.

J. Walstedt Mark, can I just give you a time check? We’re at 12:30 and we want to give Gavin enough time. Is there some way we can wrap up in five minutes?

M. Minker Absolutely. I’m about two minutes from wrapping up.

Let me share with everybody what I believe, and I’ve done research on this before the call, this is Minker’s top ten overlooked tax deductions. Number one is the ability to deduct student loan interest. Number two is the ability to deduct up to one half of the self employment tax that is paid if you are self employed and not a wage earner working for an employer. The third one, which we’ve seen a lot recently, is the ability to deduct penalties on the early withdrawal of savings from a CD or Certificate of Deposit. Number four, state income taxes that were owed in a prior year, for
those that live in tax states such as New York or Illinois, to the extent that you have taxes that were paid the prior year in the current year, you can take that current year payment as a deduction on your return.

Payment by December 31 of the final quarterly estimated tax payment is one we see overlooked quite often. And taxes paid to a foreign government. Points paid on a mortgage or to the extent that you refinance and pay points, and there are some rules you have to be aware of with respect to refinancing. But know if you pay points, there is the ability to take a deduction for them. Mileage one incurs in relation to charitable activities is deductible at $0.14 per mile. You obviously have to document that but if you are involved in a charitable organization and you’re traveling to and from, those travel expenses are deductible. Casualty and theft losses are ones we’ve seen a lot, especially in 2004 with all the different disasters that have occurred, to the extent that these losses exceed $100 and 10% of one’s income. That is an itemized deduction and is not subject to phase out at the 3% rule I spoke of earlier. Finally, one that has come up thankfully not as often but we’ve seen it a bit last year is the ability to deduct a worthless investment in stock or other security.
Those are my top ten.

The last thing I want to leave you with before I turn it over to Gavin are some changes that have occurred, and I know one participant asked this in advance, about what is new for 2004. There are a couple things, but at the end of the day the 2004 tax bill didn’t have a lot in it as it relates to individuals. There is still the ability for educators, if you are an educator or a teacher, to deduct up to $250 of teaching supply expenses whether or not you itemize. There is also the ability to take deduction for clean fuel vehicles and some of these hybrid vehicles. I’d urge you to look at the IRS site and find the IR publication 2004-125 that will have all the information in it for that. I spoke of the child tax credit, so that’s a new one.

For those that do not live in income tax states such as Texas or New Hampshire [states that do not have an income tax], there is a sales tax deduction in the table now that accompanies the 1040 form which allows you to deduct sales taxes based on, number one, where you live and, number two, the number of people in your household. Those are just some highlights in terms of some of the new law provisions available. Certainly, some of the resources I
mentioned on the Web will give you additional insight in terms of things that might be specific to your particular situation.

With that, I’ve come to the end of my time. I know we’ll have time for questions at the end. Jane, I’ll turn it over to you and let Gavin take over from there.

J. Walstedt Thank you very much, Mark. I know you had a lot to cover in a very short time and we’re glad we have only two speakers this time because it’s such a meaty topic. I want to remind the listeners that we post the audio of the calls after the call so if you miss something, you can pick it up on the Web site afterwards. We’re starting to post the transcripts, too.