

What is Alternative Minimum Tax, and why am I paying it this year?

This year, many taxpayers are falling into the category of incurring alternative minimum tax, or AMT, for the first time. AMT is just what the name implies, a minimum tax paid as an alternative to the ordinary tax calculation. The purpose of it is to close loopholes by preventing excessive use of special deductions and special treatment of certain types of income by taxpayers who would otherwise have a significant tax liability.

So why do I fall into that category now, when I didn't before? My tax situation hasn't changed that much. Your situation hasn't, but the tax laws have. The catch-22 of lower tax rates and increased deductions is that more taxpayers (about five million) will begin paying AMT this year. Tax rates have been lowered for middle to higher income levels, so if your taxable income last year and this year were as follows (see chart above), your tax rates will have decreased accordingly.

I can see that my income is eligible to be taxed at a lower rate,

2002		2003	
Married filing joint:			
Tax Rate	Threshold	Tax Rate	Threshold
27%	\$46,700	25%	\$56,800
30%	\$112,850	28%	\$114,650
35%	\$171,950	33%	\$174,700
38.6%	\$307,050	35%	\$311,950
Single:			
Tax Rate	Threshold	Tax Rate	Threshold
27%	\$27,950	25%	\$28,400
30%	\$67,700	28%	\$68,800
35%	\$141,250	33%	\$143,500
38.6%	\$307,050	35%	\$311,950

but how is AMT calculated? The calculation is complicated, adding back certain types of deductions and adjusting the amounts of special income categories used to determine taxable income, or in this case, Alternative Minimum Taxable Income. The following items are used to calculate alternative minimum taxable income:

- Add back deductions for:**
- Mortgage interest not used to buy or improve your home
 - Investment interest expense specially calculated for AMT
 - State and local income taxes, real estate taxes and personal property taxes

- Medical expenses exceeding between 7.5% and 10% of AGI
- Miscellaneous itemized deductions exceeding 2% of AGI, such as employee business expenses, tax preparation fees, investment and safe deposit box fees
- Personal exemptions and dependent exemptions
- Add back income not ordinarily taxed:**
 - Tax exempt interest on private activity bonds
 - Incentive stock options exercised
 - Accelerated depreciation deductions in excess of straight-line (normal) depreciation

Accelerated depreciation already taken on sale of property

AMT kicks in once you reach alternative minimum taxable income of \$58,000 for married filing jointly and \$40,250 for single taxpayers; however, these exemption amounts are reduced by 25% of the amount that your AMT taxable income exceeds \$150,000 for married filing jointly and \$112,500 for single taxpayers. This means that the calculations have to be completed to determine the point at which you are subject to AMT. These exemptions have decreased in 2004 to \$45,000 married filing jointly and \$33,750 single.

So what tax rate am I really paying? The AMT tax rate is 26% up to \$175,000 married filing jointly and 28% over \$175,000 married filing jointly. If the alternative minimum tax exceeds the amount of regular tax, you pay the higher amount.

continued on the next page



Bormel, Grice & Huyett Business Scholarship awarded

We are proud to announce the presentation of the fifth annual Bormel, Grice & Huyett Business Scholarship Award to Ashley Snyder of Hammond High School. Anna Huyett presented the scholarship at the school's senior awards night held on May 27, 2004. The Bormel,

Grice & Huyett Business Scholarship Award is presented annually to an area high school senior for scholastic achievement and interest in pursuing a business curriculum in college. Past recipients include students from Laurel High School in Laurel, River Hill High School in

Clarksville, Atholton High School in Columbia, and St. Vincent Pallotti High School in Laurel.

Congratulations to Ashley Snyder and the 2004 graduating class of Hammond High School. ■

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Do I lose my capital gains rates? Not necessarily. Capital gains tax is recalculated using AMT adjustments, and if the AMT exceeds the tax calculated using capital gains rates, you pay the higher amount.

What if this is a one-time change in my income? Under certain circumstances, if there is a fluctuation in tax preference income and or deductions, there is a credit available in future years, called the Credit for Prior Year Minimum Tax.

Is there anything I can do if I plan business transactions this year that may trigger AMT? Yes. Timing is everything. If you have any questions about how this may effect you in 2004, we will be happy to discuss your personal tax

situation to determine the tax effect of any business plans you have, or just to project your 2004 income and deductions. ■

Not-for-profit organizations and Form 990: "Why do you want that?"

If you are one of our many not-for-profit clients, you may find yourself asking (or at least thinking) this question as we begin the preparation of your Organization's IRS Form 990. The purpose of Form 990 is to provide the IRS, and ultimately the general public, with information about your tax-exempt organization. Since many members of the public rely on Form 990 as the primary or sole source of information about your organization, the information presented on the return will have a significant impact on how your organization is perceived. For this reason, every effort should be made to not only provide complete and accurate information but to fully describe your organization's programs and accomplishments. In fact, a website is available that provides the public with your Form 990 information in a very easy to access format (www.guidestar.org). Guidestar obtains the information from your most recent return and posts it on their website as a helpful tool for

the public to connect with charitable organizations.

One area that is extremely important in how the public evaluates your not-for-profit is how effective you are at using contributed funds for program purposes. This can be readily determined by looking at the total program service costs, management and general expenses, and fundraising expenses presented on page one of the Form 990. Obviously the accurate allocation of these costs is one of the most essential areas in the record keeping in your organization. Most organizations recognize this fact and closely monitor their costs. Keep in mind that direct expenses attributable to special events whose sole or primary purpose is to raise funds that are other than contributions (such as galas) are not included in any of these expense areas but instead are included in "line 9" in the revenue section of page one. This can be very helpful in improving your organization's program expense percentage.

Another area of importance to the public appears in Part III of Form 990. This area of the return describes the program service accomplishments of the organization. This is a great place to "toot your own horn" by describing the organization's primary exempt purpose and to highlight its achievements over the past year. Adding additional pages is perfectly acceptable! We often tend to just repeat whatever was stated in previous years, but this year may be a great opportunity to update and revitalize your organization's purpose and accomplishments.

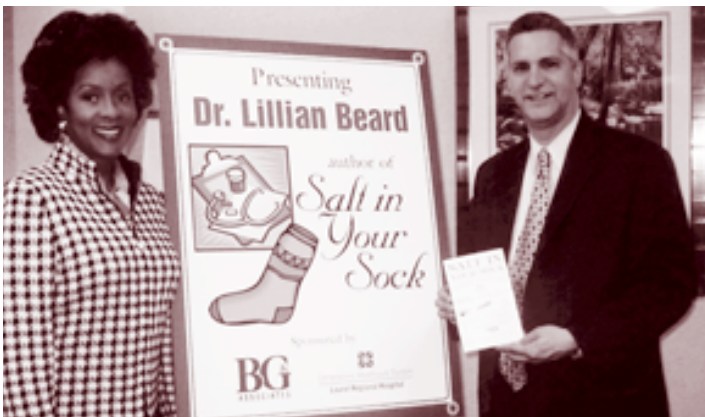
Detailed information is also requested about individual contributors. The IRS uses this information to determine if your organization has a broad base of public support. The IRS begins to be concerned if the public support percentage drops below 33% because it may indicate that the not-for-profit is really a private foundation. The contribution information you provide to us is actually used in several locations

on the Form 990 and its Schedules A & B. While the information in aggregate is available to the public, individual contributor information is not open to public inspection. (Schedule B, Schedule of Contributors, is open for public inspection for section 527 organizations).

Among the information we need to complete your Form 990 are details of compensation of officers, directors, employees, and contractors. This is presented in the return as well, so this information will also influence how potential donors assess your organization.

While you may sometimes view the Form 990 as a necessary evil for enjoying the tax-exempt status of your organization, it is important to also view it as a valuable tool for providing the public an opportunity for discovering a wealth of information about your organization's mission and achievements. ■

Bormel, Grice & Huyett sponsors book signing at Laurel Regional Hospital



Well-known pediatrician, television health commentator, and author Dr. Lillian Beard was a special guest at Laurel Regional Hospital on February 18, 2004 as she discussed and signed copies of her book *Salt in Your Sock*. As part of the hospital's observance of Black History Month, Dr. Beard delighted and

entertained the audience with her collection of home remedies for common ailments.

Thanks to a generous donation from Bormel, Grice & Huyett, some members of the audience were treated to copies of *Salt in Your Sock*. ■

Pictured are Dr. Lillian Beard and Larry Bormel.

Donation of a motor vehicle to charity

Is it worthwhile to donate your old automobile to a charity and take a tax deduction, rather than apply it as a trade-in when you buy or lease your new car? A yes-or-no decision cannot be made without examining some of the particulars involved with your vehicle and with the IRS's recent approach to automobile donations in general.

The IRS has been faced with a triple problem in dealing with the latest wave of contributions of automobiles to charities. First, there has been a blitz of print, radio and television advertisements over the past several years that promise tax savings that may exceed the amount of cash you would get from a trade-in or private sale. Many of these ads encourage individuals to take a high "blue book" value based on year and model, even if the actual car itself is in terrible shape. Second, with resources for auditing individual taxpayers at an all-time low, the IRS cannot possibly hope to audit many returns that claim charitable deductions for donated property, especially

with the millions of older automobiles available for potential deductions. Third, the IRS must watch its public relations image by treading carefully when discouraging certain types of donations to charities.

The IRS recently announced that it will embark on a systematic audit plan that focuses attention on organizations with "suspect vehicle donation plans or programs." The typical profile for these programs involves a charity that enters into a flat fee or royalty-type arrangement with a business, such as a used-car dealer. The business then uses the charity's name to solicit contributions of cars, to receive the cars (or tow them away), to do the paperwork on transferring title, and then to sell them. Abuse is particularly suspected if an insider who sets up the charity is also the individual or business that is selling the vehicles. The IRS has also announced that if there is an audit of a taxpayer, the value of the donation will be questioned, with "blue book" value no longer automatically accepted as proof of the amount of the donation.

Because of the IRS's strained audit resources, an individual taxpayer stands a good chance of being audited for the donation of an automobile only if the program to which the taxpayer donates the vehicle is singled out by the IRS as abusive. Even in that case, the amount of the deduction will also play a role in triggering an audit, particularly if the amount claimed is in excess of \$5,000, the amount above which a taxpayer must get an appraisal for property contributions when filing Form 8283, Non-cash Charitable Contributions. But the risk still remains that the issue of valuing property contributions will arise if another part of the return is being examined.

Some additional considerations to keep in mind include:

Charitable contributions of \$250 or more must be substantiated by a contemporaneous written acknowledgment from the charitable organization.

Records should be maintained to show that the car was in running

condition when donated; pictures, repair bills, and even tentative written offers by new car dealers for trade-ins should be retained.

Contributions to an organization that has a nationally recognized charity associated with it, or donations to a small organization with deep roots in a particular community, generally stand a better chance of avoiding scrutiny.

If the taxpayer believes that he or she is making more money from a tax deduction than by selling the car, the donation probably won't survive audit. The taxpayer may consider the "hassle" factor of selling vs. donating when deciding whether the vehicle presents a good opportunity for a contribution.

If you have any further questions about a tax deduction for donating an automobile to charity and how it may relate to your particular situation, please do not hesitate to call our office. ■

The tuition and fees deduction vs. education credits



Available through 2005 (unless Congress extends it), the Tuition and Fees Deduction allows up to a \$4,000 tax deduction on your 2004 federal tax return. The Tuition and Fees Deduction is 100% of the first \$4,000 of educational expenses if your income does not exceed \$65,000 for singles and \$130,000 if married

filing joint (MFJ). It is reduced to \$2,000 after the \$65,000/\$130,000 limits until income exceeds \$80,000 (single) or \$160,000 (MFJ). These higher income limits make it easier for more people to qualify for the deduction.

Many people are aware that the tax code offers two different credits for educational expenses. The Hope Credit is only available for the first two years of higher education. It provides up to \$1,500 or 100% of the first \$1,000 of education expenses, and 50% of the next \$1,000. You must be working towards a degree and be taking at least one-half the normal course workload to qualify. The Lifetime Learning Credit is available for any year without the

degree or workload requirements. It provides a maximum \$2,000 credit calculated by taking 20% of the first \$10,000 in annual educational expenses.

The problem with being able to take either credit is their low-income thresholds. For a single person the credit is reduced after income exceeds \$41,000 and is completely gone after \$51,000. For married filing joint returns the limits are between \$83,000 and \$103,000. Because of these limitations many people receive a reduced credit or none at all.

A key point is that **you cannot take both a credit and this deduction for the same student.** Expenses for both the credit and

the deduction are limited to tuition and enrollment fees paid to an eligible educational institution for yourself, your spouse, or your dependents. Eligible educational institutions include any college, university, vocational school, or other post-secondary institution eligible to participate in the financial aid programs of the Department of Education. Educational expenses are reduced by any scholarships received or other tax-free educational assistance. A tax-free distribution of earnings from a Coverdell Educational Savings Plan may reduce the deduction or credit.

Should you need any assistance with these items, please feel free to call our office. ■

Client Profile:

Bormel, Grice & Huyett, P.A. is proud to feature our client **Mobern Electric Corporation**



Mobern Electric Corporation is a manufacturer of commercial, industrial, and residential lighting.

The Company made its debut in the lighting industry in 1944 in a small storefront in Washington, D.C. Today, occupying a 160,000 square foot facility in Laurel, Maryland, they are proud to be one of the few remaining manufacturers in Howard County.

Their products are sold through electrical distributors on the East Coast and throughout the United States.

The Company prides itself on its attention to quality and detail, testing every fixture before it leaves their factory.

Mobern has been recognized throughout the industry and has received numerous awards for customer service, quality, dependability, and on-time delivery. Recently the ARC of Maryland recognized Mobern as "Employer of the Year" for employing persons with mental disabilities.

Through the years Mobern has claimed its place in the lighting arena and continues to improve and advance to the next level. The company's success comes from their values to commitment, quality, and service they call "Mobernship." ■

Tax Due Date Calendar

JUNE 15

Payment of second installment of 2004 estimated tax by individuals and trusts is due;

Second quarter of 2004 estimated tax is due by calendar year corporations.

JULY 15

Last day for filing 2003 Form 1041 for trusts that obtained an automatic three-month filing extension;

Last day for filing 2003 Form 1065 for partnerships that obtained an automatic three-month filing extension.

AUGUST 2

Second quarter 2004 payroll tax returns due;

Annual Return/Report of Employee Benefit Plan (Form 5500) is due.

AUGUST 16

Last day for filing 2003 income tax return by individuals who obtained an automatic four-month filing extension.

AUGUST 31

Due date for Heavy Vehicle Use tax return (Form 2290).

SEPTEMBER 15

Third quarter calendar-year corporation's estimated tax payment due for 2004;

Third quarter individual or trust's estimated tax payment due for 2004;

Last day for filing 2003 income tax returns by calendar-year corporations that obtained an automatic six-month filing extension.

OCTOBER 15

Last day for filing 2003 individual income tax returns for those who obtained an additional two-month filing extension.

Last day for filing 2003 Annual Return/Report of Employee Benefit Plan (Form 5500) for those who obtained a two and one-half month filing extension.

NOVEMBER 1

Third quarter 2004 payroll tax returns due.

DECEMBER 15

Payment of last installment of 2004 estimated tax by calendar-year corporations.

BG&A NEWS

Anna E.R. Huyett presented the fifth annual Bormel, Grice & Huyett Business Scholarship Award to Ashley Snyder of Hammond High School.

Brenda Cummings participated in the American Cancer Society's Relay for Life on May 14-15, 2004 by successfully completing her walk as a member of the Sunny Siders relay team. Brenda and her relay team raised over \$9,500 for the American Cancer Society.

Edie Manney participated in the March of Dimes WalkAmerica in Springfield, VA, on April 25, 2004 by successfully completing a five mile walk. Edie and her team raised over \$2,000 to help fund research on what causes premature birth and what can be done to prevent it.

Edie Manney and **Marie Bradshaw** participated in the 9th Annual Laurel 5K Run and Walk on June 5, 2004.

Marlene Collins and her husband Jim participated for the third year in the Dick Gelfman's 4th Annual Ride Across Maryland. The two-day event raised more than \$100,000 this year to benefit the Susan G. Komen Breast Cancer Foundation. All of the money raised stays in the State of Maryland. More than 600 motorcycle riders gathered at the Mall in Columbia on Saturday,

June 5th and rode to Deep Creek Lake (in not-so-nice weather) and returned on Sunday, June 6.

Kudos to **Katherine A. Grice** for heading up the Baltimore-Washington Corridor Chamber Annual Golf Tournament for the 12th year in a row. The Tournament was held at Cross Creek Golf Club and it was a major success. (The Golf Tournament raises money to help the Chamber support area businesses.)

Thank you to our entire staff for supporting the Susan G. Komen Breast Cancer Foundation. Bormel, Grice & Huyett, P.A. raised funds for the Foundation during Lee National Denim Day. Our sincere thanks to **Barbara Bormel** for organizing this event.

Congratulations to **Peter** and **Edie Manney** on the birth of their son, Alexander James. Alex was welcomed by his parents and sister Ashleigh on February 4, 2004.

Congratulations to **Scott & Brenda Cummings** on the birth of their first grandson Hayden Augustus. Happy parents are daughter Nina and son-in-law Chad Craig.

Larry P. Bormel was elected to the Board of Trustees of the Laurel Regional Hospital.

Larry also serves as chairman of the Laurel Regional Hospital Foundation.

If you haven't already done so, please visit our website at www.bormel-grice.com. Through our website you can access information about our firm and its specialty groups, the latest issue of our newsletter, and links to other sites such as tax forms and publications, Maryland Comptroller of the Treasury, Maryland Association of Certified Public Accountants, American Institute of Certified Public Accountants, Baltimore-Washington Corridor Chamber, State Department of Assessments and Taxation, Bloomberg Financial Services, and client websites. Your comments and feedback are welcome and appreciated.

The BG&A UPDATE is published for our clients, staff, and professional contacts. Copies will be provided to other business people upon written request. Any action based on information contained herein should be taken only after a detailed review of the specific situation.

The following members of our firm have contributed to this edition: **Larry Bormel, Anna Huyett, Catherine Newman, Sally Johnson, Michael Elliano, Mike Myers, Marlene Collins, Donna Peirce and Brenda Cummings.**