BONUS SECTION

USA TODAY

TAX PLANNING

MONDAY, OCTOBER 20, 1986

TODAY'S BONUS

The biggest changes . . . to affect our finances in generations will take place when President Reagan signs the new tax bill. Inside:

- The experts' best tips, 2E.
- Your worksheet to see where you stand, 3E.
- How to make your home pay you, 6E.
- The end of tax shelters? 8E.

Next Bonus Section . . . Catch up on the latest in high-tech for your home, Monday, Nov. 3.

BEST OF TAXLINE

Tax Hotline has handled more than 30,000 calls since May. Inside: the most frequently asked questions.

DATELINE

HERE'S HOW AND WHEN THE NEW TAX LAW AFFECTS YOU.

Aug. 7, 1986: Income from private-purpose municipal bonds issued after this date is tax-free unless you pay the alternative minimum tax. In that case, the income is added to your other income when calculating the AMT, which keeps people from reducing tax liability to little or nothing using legitimate write-offs.

Aug. 16, 1986: Tax bill agreement reached by House-Senate conference committee.

- Interest on home equity loans made after this date deductible only on loan balances up to amount of home's purchase price, plus improvements. Exception: Interest on loans for medical or education expenses deductible up to market value minus other mortgages.

Date bill is signed: (President Reagan expected to sign this week.)

- Losses from tax shelter investments made after this date deductible only from shelter income. For shelter investments before this date, deduction of losses against ordinary income will be phased out over four years; for 1987, 65% of shelter losses deductible against non-shelter income.

Jan. 1, 1987: Most provisions of the law take effect.

- Lower individual rates will be phased in over the next two years. This year, five individual tax rates apply: 11%, 15%, 28%, 35%, 38.5%.
- Increases in standard deductions (used by taxpayers who don't itemize deductions) will be phased in over the next two years. For 1987, the standard deduction is $3,760 for joint filers, $2,540 for single filers and heads of household, and $1,880 for married people filing separately.
- For blind taxpayers or those 65, the 1988 standard deduction applies a year early — $5,000 on a joint return, $4,400 for a head of household, $3,000 single and $2,500 for married filing separately. Blind or elderly taxpayers also get $600 deductions each if married, $750 if single.
- Personal exemptions increase over the next two years. For 1987, the exemption is $1,900. A taxpayer who is eligible to be claimed as a dependent on another's return may not take a personal exemption.
- Unearned income of a child under 14 is taxed at parents' rate for amounts that exceed $1,000.
- Consumer interest is 65% deductible; consumer interest deduction will be phased out over four years.
- Repealed: two-earner deduction, income averaging, sales tax deduction and special treatment of long-term capital gains, now fully taxed up to top rate of 28%.
- Deductions for contributions to individual retirement accounts restricted for people who are eligible for pension plans at work, depending on income.
- Unreimbursed medical expenses, which were deductible to the extent they exceeded 5% of adjusted gross income, now deductible to the extent they exceed 7.5%.
- Unreimbursed employee business expenses and other miscellaneous expenses deductible only to the extent the total exceeds 2% of adjusted gross income.
- Charitable deductions no longer deductible unless you itemize your deductions.

Jan. 1, 1988: Two individual tax rates: 15%, 28%.

- Standard deduction rises: $5,000 on a joint return, $4,400 for head of household, $3,000 for a single person, $2,500 for married filing separately.
- Personal exemptions rise to $1,950.
- There is a 5% surcharge on taxable income between $71,900 and $149,250 for joint filers (between $43,150 and $89,560 for singles) to phase out the effect of the 15% bracket. Surcharge continues on taxable income over $149,250 for married filers and $89,560 for single filers until benefit of personal exemptions is eliminated.
- Forty percent of consumer interest is deductible.
- Forty percent of most losses on shelters acquired before enactment deductible from ordinary income.

Jan. 1, 1989: Annual inflation adjustment for tax brackets and standard deductions begins.

- Personal exemption rises to $2,000.
- Twenty percent of consumer interest deductible.
- Twenty percent of losses from tax shelter investments made before tax law enactment can be deducted from ordinary income.

Jan. 1, 1990: Annual inflation adjustment for personal exemptions begins.

- Ten percent of consumer interest deductible.
- Ten percent of losses from tax shelters entered into before enactment deductible from ordinary income.

Jan. 1, 1991: Deduction for consumer interest ends.

- Deduction of tax shelter losses from ordinary income ends.

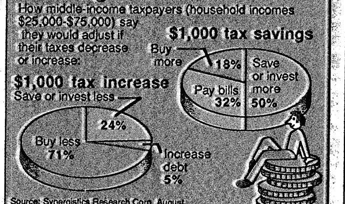
Compiled by Catherine Yang and William Giese

USA SNAPSHOTS

A look at statistics that shape your finances

Counting taxes

How middle-income taxpayers (household incomes $25,000-$75,000) say they would adjust if their taxes decrease or increase:



Source: Synergistics Research Corp. August telephone survey; 500 interviews

By Karren Loeb, USA TODAY

1987: The transition will be taxing for some

By Jim Henderson
USA TODAY

Smooth is *not* going to be the buzzword for the 1987 transition year of the new tax law.

By 1988, the average tax bill will fall 6.1% from the bite under current law.

Before that, though, "It's going to be a bumpy year, and a very expensive one for some taxpayers," says Burt Forester at the accounting firm Price Waterhouse.

The biggest bump may be a tax increase. Reason: The law will phase in the lower tax rates slowly and phase out many deductions quickly.

In 1987, according to the Joint Committee on Taxation, on average:

- Households in the $75,000 to $100,000 income range can expect a federal income tax increase of 4.3%.
- Households in the $100,000 to $200,000 range will see their tax bills jump 4.8%.
- Those with incomes above $200,000 can expect a whopping 9.8% increase.
- Households with incomes below $75,000 will see their tax bill fall — 1% for those just under $75,000 to 57.2% for those with incomes below $10,000.

The new law calls for two tax rates, 15% and 28%, plus a 5% surcharge on some upper-income households, boosting their top rate to 33%. But for 1987, there will be five rates: 11%, 15%, 28%, 35% and 38.5%. That compares with 15 rates, from 11% to 50%, under current law.

So while the lower rates will not be fully in effect in 1987, the elimination of many tax breaks will be well under way:

- 35% of consumer loan interest will not be deductible.
- 35% of losses from tax shelters can't be written off against income like wages.
- Only those miscellaneous expenses above 2% of adjusted gross income are deductible.
- The up-to-$3,000 deduction for two-earner couples will be gone.
- Long-term capital gains — profits on the sale of an asset owned longer than six months — will be taxed up to a top rate of 28%. Under current law, only 40% of a long-term gain is taxed, resulting in a maximum tax rate of 20% for someone at the current top tax rate of 50%.
- Deductions for interest on money borrowed to make investments will be limited.

Your guide to a new tax plan

An autumn review of your tax strategy for the coming year — always a sound idea — is essential this year. The sweeping changes in the federal income tax system will touch virtually every aspect of your financial life. This bonus section provides a guide to how you could be affected and what you should do about it.

By Sam Ward, USA TODAY

Life insurance escapes ax

By William Giese
USA TODAY

The new tax law took an ax to some tax-deferred investments but spared life insurance, giving it added appeal as a long-term investment.

"Life insurance is one of the great beneficiaries of the tax bill," says James Stradtner at stockbrokerage Alex. Brown & Sons Inc.

Life insurance retains its advantage: The buildup of income isn't taxed until you cash in the policy. Your heirs don't pay income tax on any death benefit. In some cases, earnings are never taxed — great for building a retirement nest egg or college fund.

Some options:

- **Single-premium whole life** allows you to invest money with income either tax-deferred or tax-free. Take Merrill Lynch Life Agency's ML-One policy. A single payment buys you a small amount of life insurance; the rest of your money is invested. Currently, a $10,000 investment by a male age 30 earns 7.5% annually; the policy includes $48,000 worth of life insurance. The rate depends on the company's return on investments.

If you cash in the policy, you pay tax on all the income. But instead of cashing in, you could borrow your money at low or no interest and avoid income taxes altogether.

In the previous example, after one year you can borrow $1,750 at no interest and 90% of the rest of your interest and principal at 2%. You never have to repay the loan; it's subtracted from the payout when you die. Technically you never collect the gain on your investment, so you're never taxed on the income.

- **Single-premium variable** life is similar except investors pick investments from a variety of mutual funds.
- **Universal life** annual payments go into a fund where the income builds up tax-deferred. Currently at Metropolitan Life Insurance Co., your investment earns up to 8% a year. That's the net after subtracting fees and the cost of death benefits.

When you withdraw money from a universal life plan, it's assumed you take your initial investment first, then taxable earnings. You can borrow from the fund, but rates usually are higher than with single-premium policies.

The tax breaks may not last, however. Congress has been talking about requiring annual tax payments on the buildup.

Picking the right insurance policy

- Get a feel for the types of investments your insurer is making. "Can you sleep with the risk of a junk bond portfolio?" says James Stradtner at stockbrokerage Alex. Brown & Sons Inc.
- Read a company's annual report to get an idea of past investment performance.
- Deal with an agent or broker you trust. Don't deal with a company rated less than an "A plus" by A.M. Best Co.

COVER STORY

How to make the most of the new rules

Go ahead: Buy a car, sell your stocks — but only if changes fit into your master plan

By William Giese
USA TODAY

For Pamela Hazel Jackson, 35, tax overhaul comes down to a decision about her nest egg: 517 shares in a growth stock mutual fund.

The Tampa, Fla., registered nurse has been buying the fund shares since 1980. She estimates that on paper she has a $7,000 long-term capital gain.

Now she and her husband Alvin, 37, a pharmacy technician, want to sell the shares worth $14,000 to make major purchases, including a car and possibly a down payment on a house.

"What I'm wondering," says Jackson, "is should we sell this year, or should we wait until next year?"

The answer? By all means, they should sell those shares in 1986. They'll save $1,050 on capital gains taxes. Bottom line: The sale will cut their total tax bill $229.

The Jacksons, who together earn about $45,000 a year, will face a $7,894 tax bill for 1986 if they sell this year, according to estimates by Josh Grauer of accounting firm Touche Ross & Co. If they sell in 1987, their bill will be $8,123.

Principal reason: changes in the rules for long-term capital gains. Currently, only 40% of profit on investments held more than six months is taxed, so even a person in the top 50% bracket pays a maximum 20% on a long-term gain. For the Jacksons, in the 33% bracket, paying taxes on 40% of profits means their total gain is taxed at an effective rate of 13%.

The new rules next year tax all capital gains as ordinary income, with a 28% top rate — more than twice their 1986 capital gains rate. So the Jacksons would be taxed $910 this year on their profits, compared with $1,960 in 1987.

The rest of us might be wondering if we can beat the new rules, too. Here are questions the early birds are asking, and the answers they're getting:

Please see COVER STORY next page ▶

By Bruce Hosking

TIME TO SELL: Pamela and Alvin Jackson are checking into the best time for selling stock.

Winners, losers under new tax law

Income	Increase[1]	Avg. inc.	Cut[1]	Avg. cut
0-$10,000	1.692	$214	12.315	$170
$10,000-20,000	4.199	235	22.463	310
$20,000-30,000	4.677	346	16.547	390
$30,000-40,000	3.519	554	10.537	554
$40,000-50,000	1.697	926	6.797	841
$50,000-75,000	2.947	1,378	4.927	1,066
$75,000-100,000	.722	3,120	1.186	2,187
$100,000-200,000	.655	8,312	1.126	5,803
More than $200,000	.311	55,700	.393	50,122
Totals[1]	20.419		76.291	
Averages		$1,742		$801

1 — in millions of people

Source: Joint Committee on Taxation.

NEXT BONUS SECTION: HIGH TECH AT HOME

TAX PLANNING: EXPERT ADVICE

Tax tips from the pros

Get tax smart — by listening to the experts. As financial planners and other authorities study the impact of the new tax law, they offer these tips on how to protect your money from the IRS.

DEDUCTIONS

Eileen Sharkey, president of financial planners E.M. Sharkey & Associates, Denver.

My short-term advice is anybody who claims miscellaneous deductions — charitable, medical or unreimbursed business expenses — take them this year. Don't defer anything. Clean out your closets and give to the Salvation Army. Prepay registrations for educational conferences. Consider having any medical work done this year or prepaying what you plan to have done next year. Get your children going on orthodontal work and try to prepay for that.

HOUSING

Ronald F. Poe, president of Mortgage Bankers Association of America, president of Dorman & Wilson Inc., White Plains, N.Y., mortgage bankers.

Tax rates will come down for home buyers in the 50% tax bracket — down to 28% or 33%. For them, the after-tax cost of mortgage interest will be greater, because the deductions won't be worth as much. Fifteen-year fixed-rate mortgages carry lower interest than 30-year fixed mortgages, so they might be more attractive — if you can afford it. Also, the market for houses in the $150,000 to $300,000 range probably will soften. I see a 10% drop in prices. As for down payments, borrowing the least amount of money makes the most sense, so make as big a down payment as you can afford. Multifamily unit rents may go up 15% to 20%, so renters might want to buy.

BORROWING

Luther R. Gatling, president of non-profit Budget and Credit Counseling Services Inc., New York.

The only consumer credit that's going to get any tax breaks is home equity loans. Buy cars and other big-ticket items now. It's the time to do it because you can deduct the sales tax and the interest you'll pay to borrow to make the purchase. I'd say use your credit cards less because you won't be able to deduct the interest.

CAPITAL GAINS

Glenda Kemple, certified public accountant, certified financial planner, Carter Financial Management, Dallas.

Would you have sold an asset soon without a tax law change? If so, sell this year. You'll pay less tax on your long-term capital gains. However, if you planned to hold the investment for the long term, don't sell now. If you do, you'll have less of your money working for you — if you're in the top tax bracket, 20% of the profit will go for taxes.

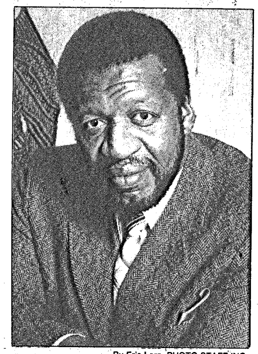
IRAs

Charles E. Battle, certified financial planner, president of Battle & Co., financial planners, Aurora, Colo.

If you have an IRA, make the maximum contribution this year and keep your money there. You'll still reduce your taxable income, and your IRA earnings will still be tax-deferred. It will lose some of the luster but not all of it. As for future contributions, you might consider an annuity, which also has tax-deferred earnings.

By Bill Janscha, USA TODAY

GLENDA KEMPLE: Selling assets now will mean less tax on capital gains.



By Eric Lars, PHOTO STAFF INC.

CHARLES BATTLE: Add to your IRA to augment tax-deferred earnings.

TAX SHELTERS

John M. Cahill, certified financial planner, Carroll/Cahill Associates, San Francisco.

There just aren't many tax shelters left. Be wary of purported tax shelters — you might be grasping at straws. About the best tax shelter left is the interest deduction on your home. So if you're renting you might want to buy.

SAVINGS

Jim Jorgensen, editor of *The Jorgensen Report* newsletter.

Savings accounts look a lot more attractive when you're paying taxes at a 28% rate rather than a 40% or 50% rate, but I don't think the inflow of savings is going to increase because of tax overhaul. There are more attractive low-risk investments. Investors with bank CDs should look at insured Government National Mortgage Association (Ginnie Mae) certificates and tax-exempt municipal bonds, both of which are yielding more than CDs.

REAL ESTATE

Phil Wiesner, partner in national tax practice of Peat, Marwick, Mitchell & Co., Washington, D.C.

Tax considerations in real estate become a lot less important because of the increased depreciation schedule. Also, tax losses are going to be limited. Real estate losses can offset real estate income, or income from so-called passive investments, such as limited partnerships, managed by others. But you won't be able to reduce your taxes on wages and other income with real estate losses. There is an exception for individuals who own rental property: Up to $25,000 of real estate losses are deductible from ordinary income.

The threat of tax reform measures has caused real estate prices — rental real estate — to drop. One view is that now might be a good time to make a real estate investment because prices are down.

INVESTMENTS

Richard Michl, certified public accountant and lawyer, president of Capital Structures Advisory Corp., a registered investment advisory firm, Chicago.

Companies will be making more efforts to sell you universal life insurance and variable life insurance policies, which include an investment feature. That's because taxes on the cash buildup in the policy are deferred until you cash it in. Be careful with variable life — you don't know what the cash value or the value of the policy is because it fluctuates with the market and has more risk.

Reported by James Cox

COVER STORY

Stocks still look good

Continued from 1E

Should I sell my stocks in 1986 or wait? Baltimore engineer Michael Lucas has mutual fund investments that, all else being equal, he would keep for several years. But he's considering cashing in those fund shares in 1986 and then buying them back. That way, he reasons, his long-term capital gains will be taxed at current lower rates.

That might not be wise if you think your investments will continue to grow in value: Money spent this year on commissions to sell a stock and taxes on stock profits no longer would be earning income — and if your stocks fall, you've paid taxes needlessly. If you were thinking of selling a profitable stock within the next few months, tax revision or not, then sell in 1986.

"But don't sell solely for tax purposes," says Richard Graber, vice president of the financial services firm Waddell & Reed.

What else do I do before the end of the year? Victoria Andrews of Howard Beach, N.Y., is buying a new Honda Civic this year. Andrews, a flight attendant, wants the sales tax deduction.

That's a good move for itemizers. If you're planning a big-ticket purchase, think about buying this year. Under the tax plan, sales taxes won't be deductible next year.

Take all possible deductions in 1986, when tax rates are higher, and defer income until next year. Ask your boss to hold your year-end bonus until January, give more to charity in 1986 and prepay state income taxes in December instead of waiting for the bill to come in January.

Which is the better investment, dividend-producing stocks or growth stocks?

Stock dividends and bond interest income will look more attractive because tax rates are being lowered; high-dividend-paying stocks such as utilities will be likely investments.

A year ago Waddell & Reed was recommending growth-stock mutual funds to middle-income families. Now the firm is suggesting mixed growth and income funds that offer a combination of appreciation and dividends.

But the planners still like growth stocks. "If you buy a stock for $5, hold it for several years and sell it for $20, that's a valuable tax-deferral device," says Graber.

What should I do about retirement? Under the new rules, some workers' $2,000 maximum individual retirement account contributions will be phased out. The phase-out hits people covered by a retirement plan at work who have more than $25,000 of adjusted gross income for singles, $40,000 for joint filers. The deduction is lost completely at $35,000 singles, $50,000 joint. Workers denied the deduction still can fund an IRA with after-tax dollars.

Maximum employee contributions to tax-deferred 401(k) retirement savings plans will drop to $7,000 from the current $30,000 beginning in 1987.

Generally, workers should fund 401(k)s and IRAs as much as possible this year, says Condron. Then consider other tax-free or tax-deferred investments, such as municipal bonds, universal life insurance and U.S. Savings Bonds, before funding a 1987 IRA with after-tax dollars.

What about my tax shelter investments? Typically, tax shelters are investments managed by others that generate paper losses in early years. Investors deduct the losses to offset their other income, such as wages and stock dividends. The tax law puts a crimp in shelters by saying losses from so-called passive investments, those managed by others, can be deducted only against passive-investment profits.

For new shelter investments, the new rule applies immediately. For investments made before President Reagan signs the bill, the law, shelter write-offs against regular income are phased out. In 1987, 65% of losses are deductible against regular income; 40% in 1988; 20% in 1989; 10% in 1990 and nothing after that.

If you expect losses in future years from a tax shelter investment, make new profit-making passive investments whose earnings can be matched against your passive losses, says P. Kemp Fain, Knoxville, Tenn., certified financial planner.

Is real estate still a good investment? "The answer is complex," says Fain. Most real estate investments are automatically classified as passive under the new rules, so losses will be deductible only against income from passive investments.

But people who own and manage rental property can deduct up to $25,000 of net real estate losses a year against wages and other ordinary income. The write-off is phased out for taxpayers (singles and joint filers) with adjusted gross incomes of more than $100,000; it's lost at the $150,000 level. Fain says individuals should still consider rental property investments.

Disagreeing is Dr. Rasik Lakhani, a Huntington, W.Va., physician who owns a six-unit apartment house in nearby Ceredo, W.Va. Lakhani plans to sell his building because tax overhaul's lower tax rates make mortgage interest and expense deductions worth less to him.

Condron also says expense deductions will be worth less when rates are lower. He believes that will force many families who own combination vacation/rental homes to sell out, hurting resort market values.

Do I need professional help? The pros say we need help to take maximum advantage of new rules. But down the road, some planners worry that they'll lose clients as the tax laws become more straightforward.

TAXLINE ON 1986

ANSWERS TO YOUR QUESTIONS ABOUT THE NEW TAX LAW

Does this new tax law take effect for our 1986 return, which we'll file in 1987, or will it be for the 1987 tax return, which we file in 1988?

— N.J., Montclair, N.J.

Most rules will kick in beginning with the 1987 tax year, for which you'll file your tax return in 1988.

What happens to the special exemptions for senior citizens and blind taxpayers?

— W.P., Lombard, Ill.

That tax break will change. Now, taxpayers get extra $1,080 personal exemptions if they are 65 or older, or blind (two extra exemptions if they're blind and 65 or older). The change: Elderly or blind taxpayers who are married will receive instead an extra $600 standard deduction; singles will get an extra $750 standard deduction. Personal exemptions go to $1,900 each in 1987 and $1,950 in 1988.

The standard deduction for all non-itemizers rises — for singles, from $2,480 in 1986 to $2,540 in 1987 and $3,000 in 1988; for married people filing jointly, from $3,670 in 1986 to $3,760 in 1987 and $5,000 in 1988.

Blind and elderly taxpayers will be able to claim the 1988 standard deduction a year early, in 1987.

What's the effect on credits for child care expenses?

— K.W., Scottsdale, Ariz.

No change. You still will get a credit of $720 for one child, $1,440 for two or more, to reduce your taxes for certain expenses for child care and dependent care (for an elderly or handicapped family member, for example) that enable you to work.

Any effect on my group health insurance?

— W.F., Midlothian, Va.

One big change: The rules make it tougher for companies to give more benefits to higher-paid executives than to rank-and-file workers. For example, a company in 1986 might offer dental insurance to top executives but not to other workers. Under the new rules, dental-plan benefits will count as income to the executives if they're the only ones to get the extra benefit. So lower-level workers might see health care plans upgraded in some cases, if a company doesn't want to charge executives for extra coverage.

Will veterans benefits be taxed?

— L.S., Indianapolis

No. Veterans Administration benefits such as pensions, disability pay and education assistance are untaxed now, and nothing in the bill will change that.

My wife needs plastic surgery on her legs. Will it be better to do this in 1986 or 1987?

— J.T., Potomac, Md.

All else being equal, you'd be better off scheduling the surgery in 1986. This year you are allowed to take a deduction for unreimbursed medical and dental expenses that exceed 5% of your adjusted gross income. Next year, you will be able to deduct only the portion that exceeds 7.5%, so your deduction will be smaller and harder to take. However, if the cost of the surgery plus your other estimated medical and dental costs for 1986 do not add up to more than 5% of adjusted gross income, you won't get a deduction this year anyway. In that case you might be better off postponing the surgery until 1987, increasing the chance of building up a bigger medical deduction that year.

I am in tax court over a dispute with the Internal Revenue Service. Assuming I eventually have to pay the IRS additional taxes plus interest, will it matter whether that payment is made in 1986 or 1987?

— W.M., Boca Raton, Fla.

Bad news: It would pay for you to settle your dispute this year if you think you'll end up owing the IRS. That's because under the new rules, interest on late tax payments will be considered consumer interest and not deductible after a phase-out period. Next year, only 65% of consumer interest will be deductible, 40% in 1988, 20% in 1989, 10% in 1990 and none after that. Tax experts say this change might unfairly pressure people to settle up in 1986 even if they have a strong argument against the IRS.

Will state and local taxes still be deductible?

— D.M., Steelton, Pa.

State and local property and income taxes still will be deductible on your federal tax return. You will lose the state and local sales tax deduction.

What happens to income averaging?

— H.D., Lakewood, Colo.

It's gone after this year. Until now, if your income in a given year was much more than the three previous years, you might save money by averaging your income over the four-year period. That no longer will be allowed.

I am a self-employed actor. Is it true that the tax plan will limit some work-expense deductions?

— J.C., Dayton, Ohio

The bill carves out a special exception for some actors. Ordinarily, unreimbursed business expenses will be included with other miscellaneous itemized deductions, such as union dues; only amounts that are more than 2% of adjusted gross income will be deductible. But performers will be allowed a full deduction from gross income (not an itemized deduction) for such expenses as agents' fees and the cost of attending auditions. The break applies only to performers who have two or more employers in the acting profession in a year, whose adjusted gross income is $16,000 or less, and who get 10% or more of their income from performing.

I am a traveling salesman. Am I affected?

— M.J., Arlington, Texas

The new law is rough on traveling salespeople, who currently get a full deduction from gross income for the cost of such unreimbursed expenses as travel, meals and lodging. Under the new rules the deduction will be available only to itemizers. Meal and lodging costs will be added to other miscellaneous itemized deductions such as tax preparation fees and safety deposit box rentals. Of the total, you'll get a deduction only for the amount exceeding 2% of your adjusted gross income. So if your adjusted gross income is $25,000 — 2% of $25,000 is $500 — and your miscellaneous costs, including unreimbursed business expenses, total $1,200, your deduction will be $700.

I am an elementary school teacher. Will the cost of classroom supplies that I purchase myself be deductible, as is now the case?

— C.G., Erie, Pa.

You won't get a full deduction for the cost of the supplies. Currently you're allowed a full deduction for such unreimbursed employee business expenses. Under the new law, the cost will be included with other itemized miscellaneous expenses and subject to the 2% floor.

What happens to deductions for charitable contributions?

— B.K., Bountiful, Utah

You'll have to itemize to take a charitable deduction. Currently, non-itemizers can take charitable deductions, too, but that break was due to expire after 1986 anyway.

Tax overhaul: What to do now

By Catherine Yang and Neil Budde
USA TODAY

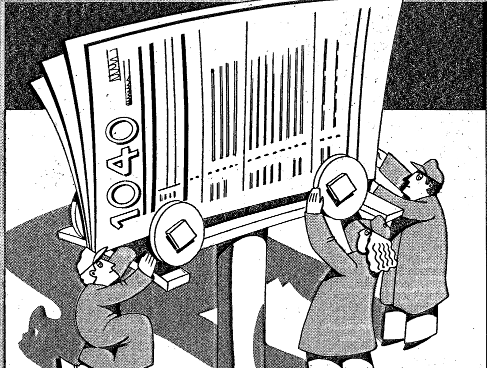
The new law may be the most important thing that's happened to your taxes since you first filed a 1040.

It will take quite a bit of calculating to see where you stand, and you might not know the effect on your bottom line for a while.

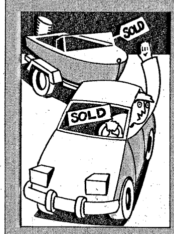
But one thing is certain: The old Rule No. 1 of tax planning — "accelerate deductions, defer income" — is even more important this year.

For one thing, some deductions will disappear. Second, the new law's lower tax rates will make the remaining deductions worth less after this year. Think of it this way: If you're taxed at a 40% rate now, every dollar you deduct cuts your taxes 40 cents. If your rate falls to 28%, you're saving only 28 cents.

You can act right now to minimize your tax bill next year and beyond:



By Bob Laird, USA TODAY



Shop early for savings

Shop, shop, shop. If you plan to buy a car, boat, motor home or other big-ticket item, buy now and save your receipts so you'll be able to deduct the sales tax if you itemize on your 1986 return.

After Dec. 31, there is no more sales tax deduction.

Itemizing pays off if you have enough deductions — taxes and loan interest are a big boost for many people — to get the total above the standard deduction for non-itemizers. This year the figure is $3,670 on a joint return and $2,480 for a single taxpayer or a head of household.

Next year, the standard deduction for non-itemizers will be $3,760 for joint filers and $2,540 for singles and household heads.

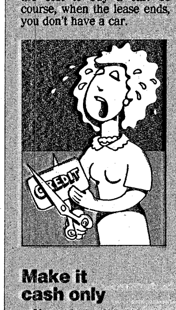
Leasing a better buy

If you're driven to have a new car, consider whether leasing would make more sense for you than buying. Besides losing the sales tax break, you'll lose the deduction for consumer loan interest, which will be phased out over the next four years. Only 65% will be deductible on your 1987 tax return, 40% in 1988, 20% in 1989, 10% in 1990 and zip after that.

That raises the total cost of buying a car.

If you like the financial freedom of driving your buggy after the payments end, you may still want to buy. But if you like to change cars every couple of years or yearn to drive a model you can't afford, leasing may be for you.

Leasing costs, including monthly payments, up-front costs and end-of-lease payments, generally are less than the cost to buy a car. Of course, when the lease ends, you don't have a car.



Make it cash only

If you have the cash, pay off as much of your debts as you can this year. The phase-out of the interest deduction will make loans more costly in the long run.

Start with your credit card debt because it carries the highest interest rate.

Consider new credit cards

Shuffle the cards. You may not have the right credit cards — the ones that cost you least — especially once the interest deduction starts to disappear.

Shop around for a card with a lower interest rate, maybe one of the variable-rate cards many banks are starting to offer. But be sure to estimate the total cost: annual fee, the interest rate (applied to the balance typically carried over) and whether there's a grace period after you charge something before the interest kicks in.

Claim every item you can

Get down to the nitty-gritty. Take all the miscellaneous itemized deductions you can now. Next year, only that portion of your miscellaneous deductions that exceeds 2% of your adjusted gross income is deductible.

For example, if your adjusted gross income is $40,000, 2% of that is $800. So if your miscellaneous deductions come to $900, then only $100 will be deductible.

Here are some ways to pile up miscellaneous deductions in 1986:

- Visit an accountant or financial planner. You have two excellent reasons to do what you've been putting off for years: You'll find out how to make the most of the new tax law, and it's your last chance to get an outline of your financial future while it's fully deductible.
- If you subscribe to professional journals or other publications targeted to your line of work or your investments, renew now for the longest term possible, and remember to pay by the end of the year.
- Ditto for professional associations and unions — pay all the dues and other costs you can this year.
- Buy work uniforms.
- If you pay for your own business cards and stationery, stock up. Don't forget card cases, calendars, pocket organizers and such.
- If you're thinking about taking a job-related course, and the boss won't be paying the tuition and other costs, sign up and pay the bill before Dec. 31.
- Pay next year's rent on a safe deposit box.
- If you're planning on looking for a job in your current field, hit the pavement now, and deduct the expenses — travel, long-distance phone calls, etc. (If you're changing your field, you don't get the deduction.)
- Buy a briefcase for your job, or a computer if you're using it because you take work home.
- If you show cats, train birds or race greyhounds for fun and profit, take your hobby losses as a deduction this year. Next year, your hobby must show profits for three out of five consecutive years, rather than two, to count as a business with deductible losses. (If your hobby is horses, the test is two years out of seven, as before.)
- If you think travel is educational — and you can prove it — take your trip now. Teachers of Latin American history should take their flights to South America by year's end, while costs are still deductible. Next year, the deduction for educational travel is eliminated.
- Take a Caribbean cruise — if it's business-related, such as a convention — this year, when you still can deduct the cost. Deductions for what the IRS calls "luxury water transportation" will be limited to twice the daily amount the government would reimburse a traveling federal employee. The current maximum is $126 a day.

Make moves by end of year

If you're planning a job-related relocation, try to do it by the end of the year. Moving expenses, which used to be deductible from your gross income to arrive at adjusted gross income, will be deductible only by itemizers. The deduction will be a new category on Schedule A; moving expenses will be 100% deductible — not subject to the 2% floor.

Giving now will pay off

Give away money or property, and get a bigger bang for your bucks.

If you're taxed at the top marginal rate of 50%, for example, a deduction for $10,000 given to your college's scholarship fund can save you $5,000 in federal income tax. Next year, as tax rates start to fall, the deduction saves you less.

And, starting next year, you can't deduct charitable contributions unless you itemize.

An incentive for makeovers

Have your tummy tucked. Or head to the orthodontist for braces, or buy yourself some new eyeglasses. If you are thinking about any elective surgery or other medical care that you can schedule at your convenience, schedule it right away. The more costs you can lump into one year, the more you'll improve the odds that you'll get a medical deduction.

Starting Jan. 1, only that portion of your medical bills that exceeds 7.5% of your adjusted gross income will be deductible. That's up from 5% under current law.

In some cases — dental care or orthodontia, for example — you may be able to prepay for services not received until next year, or make full payment even if the service drags painfully on from this year into next year.

IRA offers good outlet

Fund your individual retirement account to the maximum — $2,000 for each wage earner, $250 for a non-working spouse — while the money you put in is still guaranteed to be tax-deductible.

Next year, it gets complicated. If you're not eligible for a retirement plan at work (or, in the case of married couples who file jointly, if neither of you is eligible), you'll still be allowed to claim the full deduction.

But if you're eligible for a retirement plan — even if you don't choose to participate — your deduction might be phased out, depending on your income. *(IRAs, Page 13E.)*

Fill up your retirement tank

If you're in a 401(k), another form of tax-sheltered retirement savings plan, pour in all the money you can. Under the old law, the maximum annual contribution to your account was $30,000 or 25% of your pay, whichever was less. You and your boss could split the contribution any way you wanted.

Next year, the contribution won't change, but an employee's share is capped at $7,000.

If you need some of your 401(k) money back soon — say, if you were planning to withdraw some of it on a hardship plea to pay for a relative's nursing care or college tuition — do it now. Starting next year, you'll pay a 10% penalty on early withdrawals. And after 1988 you'll be able to withdraw early only from the amount you put in, not from any earnings or employer contributions.

A good time to sell stock

If you've been planning to sell stocks, do it before the end of the year if the sale will show a profit. Long-term capital gains — profits on the sale of investments held longer than six months — lose their preferred treatment. Now, 60% of any long-term gain goes untaxed. Next year, the entire gain will be taxed at your regular rate, up to a maximum of 28%.

If you weren't already planning to sell, don't jump just for this year's tax break. You'll still be taxed, and there's no sense in sending the government money that could keep working for you. *(Capital gains, Page 11E.)*

Re-evalute shelter losses

If you have tax shelter investments — deals intended to generate losses that you can use to reduce your salary and other income — re-evaluate them. Your ability to write off tax shelter losses against other income will be phased out between 1987 and 1990.

If you've carried forward losses you didn't claim in previous years, now might be the time to get out. Any losses you haven't already used can be taken the year that you sell.

But don't bail out too soon: If you've had the investment awhile, it may be about to start making money — and that income can be offset with losses from other investments. And, of course, after this year any income you don't write off will be taxed at lower rates. *(Tax shelters, Page 8E.)*

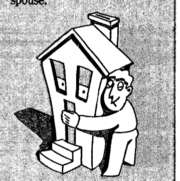
Delay income where possible

Avoid being paid until next year. Remember Rule No. 1? It's especially important now, because starting Jan. 1, income will be taxed at lower rates. Self-employed doctors, accountants and others should slow down their billing at the end of the year, trying to time it so the payments come in next year.

Alimony may be negotiable item

Head back to court if you're divorced. It may be time to renegotiate your divorce settlement. For anyone paying alimony, which is deductible, the after-tax cost is higher now that the lower tax rates make deductions less of a saving. Some divorce lawyers are arguing that alimony should be reduced to reflect the after-tax cost to the payer at the time the amount was set.

If there are children, remember that starting in 1988 higher-income taxpayers — for singles, those with taxable income of $89,560; for married couples, those with taxable income of $149,250 or more — lose the benefit of personal exemptions because a surcharge will be added to nullify them. So it would make sense to give the dependent exemption for children to the lower-earning former spouse.



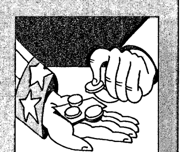
Think about buying a home

If you rent your home, give serious thought to buying. A home is still the best tax shelter around for most people. And the way the new law hits landlords, watch for rents to rise as much as 20% in the next two years.

But changes in the tax law have made the decision to buy or rent a little different from the past:

- Lower tax rates mean that the mortgage interest and property taxes you pay, though still deductible, will save you less.
- An increased standard deduction for non-itemizers means joint filers need at least $5,000 in deductions before they'd be better off itemizing. True, most people would pay $5,000 a year in interest and taxes on a home, but lower-income home buyers or people buying an inexpensive house might not make the cutoff. For them, the deductibility would be no incentive.
- In the past, without mortgage interest and taxes to get them over the standard deduction hurdle, most taxpayer/renters didn't itemize, so they couldn't write off a variety of other expenses. Some of those deductions are being eliminated, so a renter may have less incentive to buy.

If you do decide to buy, try to close the deal before the end of 1986. Some up-front "points" (a point is 1% of the loan) paid on a new mortgage are considered interest, deductible entirely in the year paid. With this year's higher tax rates, your deduction will be worth more than if you wait until 1987. *(Real estate, Page 9E.)*



Square accounts with Uncle Sam

Make up with the IRS. If you're making a partial settlement on a tax underpayment that includes interest, the IRS is willing to count the payment against the interest first if you request it. Then, if you itemize, you can deduct the interest.

TAX PLANNING: 1040 WORK SHEET

How your 1040 tax form will change

To see whether you will pay more or less taxes when the new law takes effect, dig out your 1985 federal income tax return and recalculate your taxes. The 1985 Form 1040 reproduced here and the Schedule A on Page 5E, with tax tables for 1987 and 1988, give you an idea how you'll do.

- **Lines 6a, 6b:** Exemptions are $1,900 each in 1987; $1,950 in 1988. Blind taxpayers and those 65 or older no longer get extra exemptions; they'll get an extra standard deduction instead. Dependents: You can't claim yourself as an exemption on your tax return if you are eligible to be claimed on someone else's return.
- **Lines 6c, 6d, 6e:** Starting with your return for 1988, all dependents age 5 or older must be listed by Social Security number.
- **Line 7:** Include here employee contributions to 401(k) retirement plans in excess of $7,000.
- **Line 9b:** The $100 dividend exclusion ($200 for joint filers) is eliminated.
- **Line 12:** If you managed a business that lost money, deduct the entire loss. For losses from businesses not managed by you, see Line 18.
- **Lines 13, 14:** Currently, only 40% of long-term capital gains is taxed as ordinary income. Under the new rules, all capital gains are taxed as ordinary income. (In the 1987 phase-in of new tax rates, the top rate for capital gains is 28%.) Capital losses are deductible up to the amount of your capital gains income plus $3,000.
- **Line 18:** Subject to a phase-out, losses from so-called passive investments, such as limited partnerships that are managed by others, will be deductible only against passive income. The phase-out: 65% of passive losses deductible from other income in 1987; 40% in 1988; 20% in 1989; 10% in 1990; nothing after that.
  Real estate investments are automatically considered passive, but there is an exception: Individuals can deduct up to $25,000 in losses from real estate investments managed by them. This write-off starts phasing out at $100,000 of adjusted gross income for both single and joint filers and is lost completely at $150,000.
- **Line 19:** Farm profits and losses are considered passive (see line 18) unless you are active in farm operations.
- **Line 20:** Unemployment benefits are fully taxable (partially taxable in 1986). Work sheet no longer necessary.
- **Line 24:** Eliminated. Moving expenses become an itemized deduction.
- **Line 25:** Eliminated. Include these expenses as a miscellaneous itemized deduction.
- **Line 26:** You'll probably need a worksheet to determine how much you can deduct for an IRA contribution, because the amount is based on adjusted gross income. Workers covered by a retirement plan at work (for joint-filers, only one spouse need be covered) will see a phaseout of IRA deductions starting at $25,000 of adjusted gross income for singles ($40,000 joint). The deduction is lost at $35,000 ($50,000 joint). For marrieds filing separately, the phase-out takes place over the first $10,000 of AGI; spouses' pensions don't count against you when filing separately.
- **Line 30:** Eliminated.
- **Line 32:** See Line 59 for change in earned-income credit.
- **Line 34a:** If you don't itemize, enter the standard deduction. See lines 25, 26 on Schedule A for details. If you do itemize, also see Schedule A.
- **Lines 34b, 34c, 34d, 34e, 35:** Eliminated. Charitable contributions become an itemized deduction.
- **Line 36:** Exemptions are $1,900 in 1987; $1,950 in 1988.
- **Line 38:** Figure your tax, using the tables provided on the next page. Income averaging is eliminated.
- **Line 39:** Lump-sum pension payments are eligible for five-year averaging rather than the current 10-year averaging. Taxpayers age 50 or older before Jan. 1, 1986, still would be eligible for 10-year averaging once at 1986 rates.
- **Line 43:** Eliminated.
- **Line 44:** Eliminated.
- **Line 47:** Extensive technical changes limit the foreign tax credit. Consult an expert if you currently take this credit.
- **Line 48:** Investment tax credit eliminated for most equipment put in service after Jan. 1, 1986.
- **Line 52:** Line 52: A revised 21% alternative minimum tax replaces the current 20% AMT. Affected are single taxpayers with $30,000 or more of income and couples with $40,000 or more. Even then, it only applies to people with many large deductions.
- **Line 59:** Maximum earned-income credit for the working poor increases from $550 to $800.

Form 1040 Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return 1985

For the year January 1-December 31, 1985, or other tax year beginning , 1985, ending , 19 OMB No. 1545-0074

Use IRS label. Otherwise, please print or type.
Your first name and initial (if joint return, also give spouse's name and initial) Last name | Your social security number
Present home address (number and street, including apartment number, or rural route) | Spouse's social security number
City, town or post office, state, and ZIP code | Your occupation | Spouse's occupation

Presidential Election Campaign Do you want $1 to go to this fund? Yes No
If joint return, does your spouse want $1 to go to this fund? Yes No
Note: Checking "Yes" will not change your tax or reduce your refund.

For Privacy Act and Paperwork Reduction Act Notice, see Instructions.

Filing Status (Check only one box.)
1 Single
2 Married filing joint return (even if only one had income)
3 Married filing separate return. Enter spouse's social security no. above and full name here.
4 Head of household (with qualifying person). (See page 5 of Instructions.) If the qualifying person is your unmarried child but not your dependent, write child's name here.
5 Qualifying widow(er) with dependent child (year spouse died ▶ 19). (See page 6 of Instructions.)

Exemptions (Always check the box labeled Yourself. Check other boxes if they apply.)
6a Yourself | 65 or over | Blind
b Spouse | 65 or over | Blind
Enter number of boxes checked on 6a and b ▶
c First names of your dependent children who lived with you — Enter number of children listed on 6c ▶
d First names of your dependent children who did not live with you (see page 6). (If pre-1985 agreement, check here ▶ ☐) — Enter number of children listed on 6d ▶
e Other dependents: (1) Name | (2) Relationship | (3) Number of months lived in your home | (4) Did dependent have income of $1,040 or more? | (5) Did you provide more than one-half of dependent's support? — Enter number of other dependents ▶
f Total number of exemptions claimed (also complete line 36). — Add numbers entered in boxes above ▶

			1985 actual	1985 under new law
Income (Please attach Copy B of your Forms W-2, W-2G, and W-2P here. If you do not have a W-2, see page 4 of Instructions.)				
7	Wages, salaries, tips, etc. (Attach Form(s) W-2)	7	7.	
8	Interest income (also attach Schedule B if over $400)	8	8.	
9a	Dividends (also attach Schedule B if over $400) ____, 9b Exclusion ____			
c	Subtract line 9b from line 9a and enter the result	9c	9.	
10	Taxable refunds of state and local income taxes, if any, from the worksheet on page 9 of Instructions	10	10.	
11	Alimony received	11	11.	
12	Business income or (loss) (attach Schedule C)	12	12.	
13	Capital gain or (loss) (attach Schedule D)	13	13.	
14	40% of capital gain distributions not reported on line 13 (see page 9 of Instructions)	14	14.	XXX
15	Other gains or (losses) (attach Form 4797)	15	15.	
16	Fully taxable pensions, IRA distributions, and annuities not reported on line 17 (see page 9)	16	16.	
17a	Other pensions and annuities, including rollovers. Total received 17a			
b	Taxable amount, if any, from the worksheet on page 10 of Instructions	17b	17b.	
18	Rents, royalties, partnerships, estates, trusts, etc. (attach Schedule E)	18	18.	
19	Farm income or (loss) (attach Schedule F)	19	19.	
20a	Unemployment compensation (insurance). Total received 20a			
b	Taxable amount, if any, from the worksheet on page 10 of Instructions	20b	20b.	
21a	Social security benefits (see page 10). Total received 21a			
b	Taxable amount, if any, from worksheet on page 11. {Tax-exempt interest ____}	21b	21b.	
22	Other income (list type and amount—see page 11 of Instructions) (Please attach check or money order here.)	22	22.	
23	Add lines 7 through 22. This is your **total income** ▶	23	23.	
Adjustments to Income (See Instructions on page 11.)				
24	Moving expense (attach Form 3903 or 3903F)	24	24.	XXX
25	Employee business expenses (attach Form 2106)	25	25.	XXX
26	IRA deduction, from the worksheet on page 12	26	26.	See below line 32
27	Keogh retirement plan deduction	27	27.	
28	Penalty on early withdrawal of savings	28	28.	
29	Alimony paid (recipient's last name ____ and social security no. ____)	29	29.	
30	Deduction for a married couple when both work (attach Schedule W)	30	30.	XXX
31	Add lines 24 through 30. These are your **total adjustments** ▶	31	31.	
Adjusted Gross Income				
32	Subtract line 31 from line 23. This is your **adjusted gross income.** If this line is less than $11,000 and a child lived with you, see "Earned Income Credit" (line 59) on page 16 of Instructions. If you want IRS to figure your tax, see page 13 of Instructions ▶	32	32.	
	IRA deduction		XXX	
	Final AGI		XXX	

Form 1040 (1985) Page 2

			1985 actual	1985 under new law
Tax Computation (See Instructions on page 13.)				
33	Amount from line 32 (adjusted gross income)	33	33.	
34a	If you itemize, attach Schedule A (Form 1040) and enter the amount from Schedule A, line 26. Caution: If you have unearned income and can be claimed as a dependent on your parents' return, check here ▶ ☐ and see page 13 of Instructions. Also see page 13 if you are married filing a separate return and your spouse itemizes deductions, or you are a dual-status alien.	34a	34a.	
b	If you do not itemize but you made charitable contributions, enter your cash contributions here. (If you gave $3,000 or more to any one organization, see page 14.)	34b	b.	XXX
c	Enter your noncash contributions (you must attach Form 8283 if over $500)	34c	c.	XXX
d	Add lines 34b and 34c. Enter the total	34d	d.	XXX
e	Divide the amount on line 34d by 2. Enter the result here	34e	e.	XXX
35	Subtract line 34a or line 34e, whichever applies, from line 33	35	35.	XXX
36	Multiply $1,040 by the total number of exemptions claimed on line 6f (see page 14)	36	36.	
37	**Taxable income.** Subtract line 36 from line 35. Enter the result (but not less than zero)	37	37.	
38	Enter tax here. Check if from ☐ Tax Table, ☐ Tax Rate Schedule X, Y, or Z, or ☐ Schedule G	38	38.	
39	Additional taxes. (See page 14 of Instructions.) Enter here and check if from ☐ Form 4970, ☐ Form 4972, or ☐ Form 5544	39	39.	
40	Add lines 38 and 39. Enter the total ▶	40	40.	
Credits (See Instructions on page 14.)				
41	Credit for child and dependent care expenses (attach Form 2441)	41	41.	
42	Credit for the elderly and the permanently and totally disabled (attach Schedule R)	42	42.	
43	Residential energy credit (attach Form 5695)	43	43.	XXX
44	Partial credit for political contributions for which you have receipts	44	44.	XXX
45	Add lines 41 through 44. These are your total personal credits	45	45.	
46	Subtract line 45 from line 40. Enter the result (but not less than zero)	46	46.	
47	Foreign tax credit (attach Form 1116)	47	47.	
48	General business credit. Check if from ☐ Form 3800, ☐ Form 3468, ☐ Form 5884, ☐ Form 6478	48	48.	
49	Add lines 47 and 48. These are your total business and other credits	49	49.	
50	Subtract line 49 from line 46. Enter the result (but not less than zero) ▶	50	50.	
Other Taxes (Including Advance EIC Payments)				
51	Self-employment tax (attach Schedule SE)	51	51.	
52	Alternative minimum tax (attach Form 6251)	52	52.	
53	Tax from recapture of investment credit (attach Form 4255)	53	53.	
54	Social security tax on tip income not reported to employer (attach Form 4137)	54	54.	
55	Tax on an IRA (attach Form 5329)	55	55.	
56	Add lines 50 through 55. This is your **total tax** ▶	56	56.	
Payments (Attach Forms W-2, W-2G, and W-2P to front.)				
57	Federal income tax withheld	57	57.	
58	1985 estimated tax payments and amount applied from 1984 return	58	58.	
59	Earned income credit (see page 16)	59	59.	
60	Amount paid with Form 4868	60	60.	
61	Excess social security tax and RRTA tax withheld (two or more employers)	61	61.	
62	Credit for Federal tax on gasoline and special fuels (attach Form 4136)	62	62.	
63	Regulated Investment Company credit (attach Form 2439)	63	63.	
64	Add lines 57 through 63. These are your **total payments** ▶	64	64.	
Refund or Amount You Owe				
65	If line 64 is larger than line 56, enter amount **OVERPAID** ▶	65	65.	
66	Amount of line 65 to be **REFUNDED TO YOU** ▶	66	66.	
67	Amount of line 65 to be applied to your 1986 estimated tax ▶ 67		67.	
68	If line 56 is larger than line 64, enter **AMOUNT YOU OWE.** Attach check or money order for full amount payable to "Internal Revenue Service." Write your social security number and "1985 Form 1040" on it. Check ▶ ☐ if Form 2210 (2210F) is attached. See page 17. Penalty: $	68	68.	

Source: Ernst & Whinney

TAX PLANNING: SCHEDULE A WORK SHEET

Changes to deductions

Schedule A

● **Line 4:** Multiply adjusted gross income (line 33 on the 1040) by 7.5% rather than the current 5%.

● **Lines 8a, b:** Eliminated.

● **Line 11:** Mortgage interest still deductible on first and second homes on loans up to the cost of the homes plus improvements. Interest on mortgages dated Aug. 16, 1986, or earlier, is fully deductible on loans up to the market value of the home. Interest on home-secured loans to pay for medical or education costs is deductible for loans up to the market value of the home, minus any other mortgages.

● **Lines 12, 13:** Consumer interest deduction eliminated after a phase-out: 65% deductible in 1987; 40% in 1988; 20% in 1989; 10% in 1990; nothing after that. Interest on investment loans, such as stock margin accounts, is deductible only against investment income.

● **Lines 20-23:** Add up all your miscellaneous deductions — including the unreimbursed employee business expenses. You can deduct amounts exceeding 2% of adjusted gross income.

NEW: Moving expenses are a new itemized category, but not subject to 2% floor.

● **Lines 25, 26:** Line 25 eliminated. Current tax tables build in zero-bracket amounts. These are replaced by standard deductions for non-itemizers. For 1987: joint filers, surviving spouses, $3,760; singles, unmarried heads of households, $2,540; married filing separately, $1,880. For 1988: joint filers, surviving spouses, $5,000; unmarried heads of households, $4,400; singles, $3,000; marrieds filing separately, $2,500.

In addition, taxpayers age 65 or older and blind taxpayers get extra standard deductions worth $750 for singles and $600 each if married. Also, blind and elderly taxpayers get the larger 1988 standard deduction a year early. So for 1987 a single, blind, elderly taxpayer gets to take a $3,000 standard deduction plus an extra $1,500 deduction.

Bottom line

Your net write-off (it goes on Line 34a of the 1040) is either the standard deduction or your itemized total on Line 24 of Schedule A, whichever is greater.

SCHEDULES A&B (Form 1040)
Department of the Treasury
Internal Revenue Service

Schedule A—Itemized Deductions
(Schedule B is on back)
▶ Attach to Form 1040. ▶ See Instructions for Schedules A and B (Form 1040).

OMB No. 1545-0074
1985
07

Name(s) as shown on Form 1040 | Your social security number

			1985 actual	1985 under new law
Medical and Dental Expenses (Do not include expenses reimbursed or paid by others.) (See Instructions on page 19.)	1	Prescription medicines and drugs; and insulin	1	
	2 a	Doctors, dentists, nurses, hospitals, insurance premiums you paid for medical and dental care, etc.	2a	
	b	Transportation and lodging	2b	
	c	Other (list—include hearing aids, dentures, eyeglasses, etc.) ▶	2c	
	3	Add lines 1 through 2c, and write the total here	3	
	4	Multiply the amount on Form 1040, line 33, by 5% (.05)	4	
	5	Subtract line 4 from line 3. If zero or less, write -0-. **Total** medical and dental ▶	5	
Taxes You Paid (See Instructions on page 20.)	6	State and local income taxes	6	
	7	Real estate taxes	7	
	8 a	General sales tax (see sales tax tables in instruction booklet)	8a	XXX
	b	General sales tax on motor vehicles	8b	XXX
	9	Other taxes (list—include personal property taxes) ▶	9	
	10	Add the amounts on lines 6 through 9. Write the total here. **Total** taxes ▶	10	
Interest You Paid (See Instructions on page 20.)	11 a	Home mortgage interest you paid to financial institutions	11a	
	b	Home mortgage interest you paid to individuals (show that person's name and address) ▶	11b	
	12	Total credit card and charge account interest you paid	12	
	13	Other interest you paid (list) ▶	13	
	14	Add the amounts on lines 11a through 13. Write the total here. **Total** interest ▶	14	
Contributions You Made (See Instructions on page 21.)	15 a	Cash contributions. (If you gave $3,000 or more to any one organization, report those contributions on line 15b.)	15a	
	b	Cash contributions totaling $3,000 or more to any one organization. (Show to whom you gave and how much you gave.) ▶	15b	
	16	Other than cash. (You must attach Form 8283 if over $500.)	16	
	17	Carryover from prior year	17	
	18	Add the amounts on lines 15a through 17. Write the total here. **Total** contributions ▶	18	
Casualty and Theft Losses	19	Total casualty or theft loss(es). (You must attach Form 4684 or similar statement.) (See page 21 of Instructions.) ▶	19	
Miscellaneous Deductions (See Instructions on page 21.)	20	Union and professional dues	20	
	21	Tax return preparation fee	21	
	22	Other (list type and amount) ▶	22	
	23	Add the amounts on lines 20 through 22. Write the total here. **Total** miscellaneous ▶	23	
		Moving expenses ▶	XXX	
Summary of Itemized Deductions (See Instructions on page 22.)	24	Add the amounts on lines 5, 10, 14, 18, 19, and 23. Write your answer here.	24	
	25	If you checked Form 1040 { Filing Status box 2 or 5, write $3,540; Filing Status box 1 or 4, write $2,390; Filing Status box 3, write $1,770 }	25	XXX
	26	Subtract line 25 from line 24. Write your answer here and on Form 1040, line 34a. (If line 25 is more than line 24, see the Instructions for line 26 on page 22.) ▶	26	

Source: Ernst & Whinney

The tax rates

Use these tables to figure how much tax you would pay on your taxable income. (line 38 of Form 1040). A set of five transition rates will be used in 1987. In 1988, there will be only two tax rates — 15% and 28% — but a third rate of 33% also will be used to phase out the benefit of the 15% for higher income taxpayers. Eventually, higher-income taxpayers would pay 28% on all their taxable income.

1987

Single taxpayers

If taxable income is more than	but not more than	Tax rate is	of amount over
0	$1,800	11%	$0
$1,800	$16,800	$198+ 15%	$1,800
$16,800	$27,000	$2,448+ 28%	$16,800
$27,000	$54,000	$5,304+ 35%	$27,000
$54,000		$14,754+ 38.5%	$54,000

Joint filers*

If taxable income is more than	but not more than	Tax rate is	of amount over
0	$3,000	11%	$0
$3,000	$28,000	$330+15%	$3,000
$28,000	$45,000	$4,080+28%	$28,000
$45,000	$90,000	$8,840+35%	$45,000
$90,000		$24,590+38.5%	$90,000

*Rates for married couples filing separately are half the joint rate. For example, 11% on the first $1,500, 15% from $1,501 to $14,000, etc.

Heads of household

If taxable income is more than	but not more than	Tax rate is	of amount over
0	$2,500	11%	$0
$2,500	$23,000	$275+15%	$3,000
$23,000	$38,000	$3,350+28%	$28,000
$38,000	$80,000	$7,550+35%	$45,000
$80,000		$22,250+38.5%	$90,000

1988

Single taxpayers

If taxable income is more than	but not more than	Tax rate is	of amount over
0	$17,850	15%	$0
$17,850	43,150	$2,678+28%	$17,850
$43,150	89,560	$9,762+33%	$43,150
$89,560		28% of entire amount	

Joint filers*

If taxable income is more than	but not more than	Tax rate is	of amount over
0	$29,750	15%	$0
$29,750	$71,900	$4,463+28%	$29,750
$71,900	$149,250	$16,265+33%	$71,900
$149,250		28% of entire amount	

*Rates for married couples filing separately are 15% on the first $14,875, 28% on the amount exceeding that.

Heads of households

If taxable income is more than	but not more than	tax rate is	of amount over
0	$23,900	15%	$0
$23,900	$61,650	$3,585 + 28%	$29,750
$61,650	$123,790	$14,155 + 33%	$61,650
$123,790		28% of entire amount	

NOTE: After you have reached the point where you pay 28% on all your taxable income ($149,250 for joint filers, $89,560 for singles and $123,790 for heads of households), the law imposes an additional 5% surcharge. That wipes out the effect of all personal exemptions. It will take a 5% surcharge on $10,920 of taxable income to phase out each $1,950 exemption claimed.

Take, for example, a couple filing jointly in 1988 with $200,000 of taxable income and two personal exemptions claimed. The tax rate is 15% on the first $29,750 of taxable income; 28% from $29,751 to $71,900; 33% from $71,901 to $149,250. It also is still 33% from $149,250 to $171,090 ($21,840 worth of taxable income to phase out the two exemptions); and 28% on the last $28,910.

Source: Joint Tax Committee

TAX PLANNING: STRATEGIES FOR BORROWING

TAXLINE ON HOME EQUITY

ANSWERS TO YOUR QUESTIONS ABOUT THE NEW TAX LAW

What are the new rules on deducting home-loan interest?

— L.H., Wilmington, Del.

You'll be allowed a deduction for interest on mortgages and other loans secured by your principal residence and a second home. The deduction will be limited to the interest on loan amounts up to the purchase price plus improvements. So if you have one house that you bought for $70,000 and you add $5,000 in improvements, you can deduct interest expense on home loan balances up to $75,000. If you borrowed against your home by Aug. 16, 1986, interest is fully deductible on loans up to the home's market value. There is also an exception for home-secured loans to pay for medical or education costs: Interest will be deductible up to the market value minus other mortgages.

Last January we bought a new Cadillac. I know the interest on the car loan is deductible in 1986, but what about after that? Would it be possible to take a second mortgage on our house this year to pay off the car loan?

— R.K., Batavia, Ohio

Yes. Interest on consumer loans, including car loans, won't be deductible after a phase-out. In 1987, 65% of consumer-loan interest will be deductible; 40% in 1988; 20% in 1989; 10% in 1990; and nothing after that. Interest on a qualified loan secured by a house will be deductible no matter what you do with the money. So using a home loan to pay off your car loan might save you money.

Will interest on a home equity loan taken out to pay dental bills be deductible?

— D.Z., Philadelphia

Yes. The general rule is that interest on a home equity loan is deductible if the loan is secured by your principal home or a second home, and your total loans on the two houses total no more than their purchase prices plus the cost of improvements.

On top of that, the new rules allow extra interest deductions for any home equity loans used to pay education and medical expenses. Interest on home equity loans to pay dental bills will be deductible up to the current market value of your home, minus other outstanding mortgages.

I took out a personal loan to install central air conditioning in my home. Will the interest expense on this loan be deductible?

— R.S. Chamblee, Ga.

No. That is a consumer loan because it is not secured by your home, so you will lose the interest deduction after the phase-out. However, because central air conditioning is a home improvement, the cost will increase the maximum amount on which you could deduct mortgage interest.

What about interest deductions on a mobile home loan?

— C.S., Pittsburgh

You will be allowed to deduct loan interest expense on a mobile home that is used as your principal residence or as a second home. Otherwise it will be considered a non-deductible consumer loan subject to the interest phase-out.

Consumer loans homeward bound

By William Giese
USA TODAY

What's changing: Deductibility of consumer interest.

What it means: Consumer interest deductions will be phased out over four years. More borrowers will be using home equity loans. Mortgage interest remains deductible.

Taxpayers claimed interest deductions (including mortgages) on 34.6 million returns in 1984.

Thanks to the new, not-so-simple tax law, we may be taking out loans on the family home to buy a car, to pay off a credit card balance or to take a skiing trip to Aspen, Colo.

That's because the current rule allowing tax deductions for loan interest will be tipped on its ear starting next year, when interest deductions on consumer loans will be eliminated in a four-year phase-out. In 1987, only 65% of consumer interest will be deductible, 40% in 1988, 20% in 1989, 10% in 1990 and nothing after that.

At the same time, interest deductions still will be allowed on loans secured by a mortgage on your principal or second home — up to certain limits — even if the loan is used for such non-home purposes as buying a boat or paying off your credit cards.

Starting in 1987, you'll be allowed full interest deductions on mortgage loan amounts up to the purchase price of your home, plus improvements. That means you usually can't borrow against the amount your home has appreciated.

Of the $54,000 average equity, 65% is appreciation, says Purdue University's Credit Research Center. That leaves 35%, $18,900 on average, available under a home equity line.

Appreciation can be tapped under exceptions in the rules:

■ Interest on home-secured loans to pay medical and education costs is deductible on loans up to the current market value of your home, minus any other mortgages.

■ Interest on loans made by Aug. 16, 1986 (the date the bill's details emerged), will remain fully deductible even if the loans exceed the home's price plus improvements.

Over the years you could tap your equity again and again, eventually far exceeding the price of your home and improvements — as long as the total owed at any one time did not exceed the limits.

One other exception: We'll be allowed to deduct interest for any type of loan used to pay for investments, such as stock purchases. The deduction is limited to the amount of investment income after subtracting losses. So if you used a home-secured loan to make investments, that interest could be deductible for loan amounts that exceed the ordinary mortgage loan limits.

The new rules make traditional car loans and credit card purchases more expensive after tax costs than a home loan, say, to buy a new car. That's why lenders are touting home equity loans.

The 55 million USA families who own their own homes have an estimated $3 trillion of equity in their homes — an average of more than $54,000.

Home equity gives owners credit options

By William Giese
USA TODAY

When Phyllis Burgess of Kennesaw, Ga., thinks of home equity loans, it's in terms of coins, computers and the 1976 Lincoln Continental she's thinking of trading for something in the midsize range.

Toms River, N.J., elementary school teachers Ronald and Linda Janesko are considering opening up a credit line secured by the four-bedroom, two-story home they built for $50,000 in 1973, just in case they need a loan somewhere down the road.

The new tax law makes such home loans for non-home purchases suddenly more attractive, because you'll be allowed to deduct interest on home loans (up to certain limits; see TaxLine at left) but not on consumer loans.

Do you need a fast home equity loan, too?

"Don't do anything dramatic," urges Jerry Leamon, director of executive financial counseling with the accounting firm Deloitte Haskins & Sells. "It's important to step back and consider what's best."

First, review current debt and see which, if any, consumer loans could be paid off by borrowing on a deductible home equity account, says Leamon. For example, you might want to pay off an existing boat loan with proceeds from a home equity loan, because your boat loan interest deduction is about to be phased out.

Then figure out whether your after-tax interest expense on a home equity loan is cheaper than your current loan. Don't scrap your 3% student loan, for example, for a 10% home equity arrangement.

As a rule of thumb, Deloitte Haskins & Sells estimates that for a five-year loan from 1987 to 1991, a 10% home equity loan with $250 in closing costs would be cheaper after taxes than a consumer loan with interest of more than 8.88%.

But watch out — a home equity loan can be dangerous. It may be too easy to eat into the equity in your house to pay for unnecessary purchases.

Don't pay for impulse purchases using a home equity loan, says George Barbee, executive director of Consumer Financial Institute in Newton, Mass. "If you start frittering it away in small chunks, that's a real warning sign."

FUTURE COLLATERAL: Ronald and Linda Janesko of Toms River, N.J. may use their home, built for $50,000 in 1973, to secure a credit line for future loan needs.

Phyllis Burgess and her husband, Robert, an accounting systems consultant, got a $23,000 home equity line of credit on their three-bedroom split-level two years ago in order to consolidate $18,000 worth of bills.

This year the Burgesses charged $10,000 worth of IBM hardware and software, used partly by the family and partly for Robert's consulting business, on a Sears, Roebuck & Co. credit card at 21%. The couple bought $1,000 worth of gold and silver coins on a Visa card at 18%.

Those high interest costs will get even more expensive next year, when the deduction starts to be phased out, says Leamon. Even without tax overhaul the Burgesses would be better off paying off the credit cards with their home equity loan, a variable-rate loan now at 10%.

Should you buy a new car next year with a home equity loan? Interest rates on car loans from automakers have been low, lately under automakers' cut-rate financing programs. It's hard to say if the programs will be around when you want to buy, but check all available rates before buying.

'Glorified 2nd mortgage' — here's how it works

By William Giese
USA TODAY

What, exactly, is a home equity loan?

"It's just a glorified second mortgage," says John Hayt, president of Old Stone Credit Corp. in Jacksonville, Fla., and a director of the National Second Mortgage Association.

A second mortgage is a loan secured by a lien on your home. A first-mortgage holder has first crack at your house in the case of a loan default; a second-mortgage holder is next in line for what's left.

About 85% of all second mortgages, such as home improvement loans, are conventional loans, says Hayt.

However, the home equity loans that make up the remaining 15% are a bit fancier — second mortgages that give you an automatic line of credit to use when you need it.

Under a home equity loan, you arrange with a lender for a line of credit secured by your home. You can write special checks up to the approved amount, and you make payments on the monthly revolving balance. A typical monthly payment, including interest and principal, is 2% of your balance.

Here's how it works: Say the home you bought for $55,000 is worth $100,000 now and you have $40,000 left to pay on it.

The maximum credit line usually is 80% of the appraised value of your home, minus any existing mortgages.

So, for a house appraised at $100,000, your line of credit would be up to $40,000 — $80,000 (80% of the value) minus the $40,000 existing mortgage.

But now the tax rules add another limit: On a home equity loan taken out after Aug. 16, 1986, the mortgage interest generally is deductible only on loan balances totaling the purchase price plus any improvements — in this case, $55,000. After you subtract the $40,000 first mortgage balance, you're left with $15,000. A bank probably would lend you more, but the interest wouldn't be deductible.

The average balance on a line of credit is between $10,000 and $15,000, says George Kilguss Jr., vice president of Citizens Savings/Citizens Trust in Providence, R.I.

For new homeowners, home equity loans aren't much of an option. These days, the average home buyer pays 20% to 25% cash and borrows the rest, according to the National Association of Realtors. If a newly purchased home is 80% mortgaged, there's no equity to tap.

Of course, if the loan is for a home improvement — say, to add a sun room or remodel a kitchen — that doesn't matter. You're boosting your home's value, and thus the equity against which you can borrow. Remember, the new limit for the interest deduction is purchase price *plus improvements*.

Home equity interest rates are in the 9% to 10% range now, says Gail Liberman of *Bank Rate Monitor*. Some lenders are offering introductory rates as low as 5.9%, but they rise after a few months.

Careful, though: Annual interest charges on home equity loans often fluctuate based on the prime rate. If inflation heats up again, your rate will rise.

"I don't know of a major bank that isn't doing strategic planning to aggressively get into this market," says Patrick Harrison, executive vice president of Commerce Union Bank in Nashville, Tenn., chairman of the American Bankers Association consumer credit division.

Lenders already are at war in Atlanta: Competing banks are waiving initial costs on home equity loans, including appraisals, title searches and points. Those up-front costs normally can run $500 or more for a $25,000 line of credit.

Atlanta-based Georgia Federal Bank is waiving closing costs and annual fees. The bank offers a variable interest rate, currently 9.4%.

Georgia Federal has received 5,000 applications since Aug. 1, compared with only 1,000 for all of 1985.

An after-tax comparison

Here's a comparison of the after-tax interest cost of a five-year, $10,000 home equity loan at 10% interest (with deductible mortgage interest), and an 11% unsecured loan (with the consumer interest deduction phased out by 1991):

10% interest[1]

Year	Interest expense	After-tax cost[2]
1987	$977	$703
1988	$807	$581
1989	$619	$446
1990	$412	$297
1991	$183	$132
Total	$2,998	$2,159

11% unsecured[3] loan

Year	Interest expense	After-tax cost[2]
1987	$1,022	$836
1988	$838	$744
1989	$633	$597
1990	$404	$393
1991	$149	$149
Total	$3,045	$2,719

1-Home equity loan includes 2.5 points ($250 in up-front charges) amortized over the life of the loan.
2-Assumes a top 28% tax rate in both cases.
3-Typical rate for an unsecured line of credit.
Source: Deloitte Haskins & Sells

USA TODAY

TAX PLANNING: LOSING WRITE-OFFS

TAXLINE ON REAL ESTATE

ANSWERS TO YOUR QUESTIONS ABOUT THE NEW TAX LAW

In the new rules, what is meant by a passive investment? Is my rental property considered a passive investment?
— D.M., Huntsville, Md.

Yes. Passive investments generally are ones that are managed by others, such as limited partnerships. Under the new law, passive losses on an investment will be deductible only up to the amount of any income from passive investments. However, the proposal treats all real-estate investments — even if you're actively involved — as passive. Then it makes an exception for rental real estate owned by individuals. Individual owners will be allowed to write off up to $25,000 of rental property losses against other income such as wages, bond interest or stock dividends. Losses of more than $25,000 will be deductible only to offset other passive income. The $25,000 break starts to be phased out for singles and joint filers with $100,000 ($50,000 for married filing separately) or more of adjusted gross income (not counting the loss or an IRA deduction) and is lost completely at $150,000 ($75,000 for married filing separately).

How will this affect real estate limited partnerships that were entered into in 1985?
— C.M., Gaithersburg, Md.

The write-off of passive losses will be phased out over four years for taxpayers like you who invested before the day President Reagan signs the law. Passive losses will be 100% deductible from regular income in 1986, 65% in 1987, 40% in 1988, 20% in 1989, 10% in 1990 and not at all after that. But remember, you still will be able to use limited partnership losses to offset income from other passive investments. So if you had one partnership with losses and another generating income, you could use the losses from one to offset profits from the other.

What happens to real estate depreciation?
— M.B., Brimfield, Ohio

It changes to your disadvantage. Currently, depreciation on real estate is allowed over 19 years, and you can take a larger share of the write-offs in the early years. For property bought after this year, you will deduct the cost of residential real estate in equal installments over 27½ years; non-residential property will be depreciated over 31½ years. If you buy this year, you are eligible for the current accelerated depreciation rate.

I recently put my house up for sale. Would I do better to wait and sell it in 1987?
— J.C., Elberta, Ala.

First, your home sale profits, assuming you've owned the house for more than six months, will be taxable as a long-term capital gain. If you sell this year, under current capital gains rules, you will pay tax on just 40% of your profits. So even if you are in the top marginal tax bracket — 50% — the rate works out to no more than 20%. Next year, under the new law, all long-term capital gains will be taxed as ordinary income, up to a top 28% rate. So if you've got a choice and expect to pay tax on your profits, sell this year.

Remember, though, that your profit on the sale of a house is not taxed at the time of the sale as long as you buy another house that costs at least as much as the old one within two years either way of the sale date. If the new house costs less, you must pay taxes on the lesser of either your house sale profits or on the difference between the prices of the old and new home.

Under current law, if I'm 55 or older and sell my house I don't have to pay taxes on $125,000 of the gain. Will that rule still apply under the new law, or should I hurry up and sell my house before the end of the year?
— P.B., Elmont, N.Y.

No change here. This one-time $125,000 exclusion when a homeowner 55 or older sells a principal residence will survive under the new rules.

Are points deductible on a mortgage in 1986?
— R.S., Poughkeepsie, N.Y.

Maybe. Points are extra charges that home buyers sometimes must pay up front to mortgage lenders. Each point equals 1% of the loan. Points for a new mortgage or home improvement loan are deductible in the year they are paid. However, the Internal Revenue Service says points charged for refinancing your home, rather than buying a new one, can be deducted only in installments over the life of the mortgage. None of that will change.

Will interest on a loan to buy a time share in a vacation condominium be deductible as mortgage interest expense?
— E.C., Nashville

Probably not. Interest on time-sharing contracts, which give you rights to a beach condominium, say, for a certain number of weeks a year, will not be deductible, many tax experts say — but the opinion is by no means unanimous. Arguing against deductibility is the fact that time-share contracts typically buy the right to use a residence, not the residence itself. Because the new law allows interest deductions only on loans secured by a first or second residence, a time-share contract loan not secured by a residence will not be deductible. However, this is definitely still a fuzzy area, tax experts say, and it might take an Internal Revenue Service ruling or a Tax Court case to settle the matter.

What about the current special incentive for preserving historic buildings?
— F.J., Salt Lake City

It gets smaller. Under current law taxpayers are allowed a maximum 25% tax credit for the cost of rehabilitating historic structures and up to 20% for rehabilitating old buildings. Tax overhaul rules drop that credit to 20% for historic buildings and 10% for buildings built before 1936.

Is a minister's housing allowance still tax-free?
— J.W., Seguin, Texas

Yes. Rabbis and ministers are allowed a tax-free housing allowance from their synagogue or church. Because of that, the clergy and the IRS have squabbled for years about the deductibility of home-mortgage interest. Clergy members say all their mortgage interest expense should be deductible; the IRS says part of the expense should not be deductible if ministers also receive the tax-free allowance. The tax law gives ministers and rabbis the entire interest expense deduction.

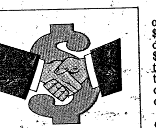
I understand some loss write-offs will be disallowed under the new tax law. What happens to those losses? Are they lost entirely, or can you use them in future years?
— B.H., Pittsburgh

You can carry losses forward to future years. For example, the law restricts loss write-offs from so-called passive investments, such as limited partnerships, which are managed by others. Passive losses will be used only to offset income from passive investments on new shelters as soon as the law is signed; it will be phased out for existing shelters. However, losses not written off can be carried forward indefinitely to future years for use against future passive profits.

Death knell tolls for most shelters

By Neil Budde
USA TODAY

What's changing:
Write-offs from any investments you don't actively manage.
What it means:
Deductions for shelter losses will be limited to the amount of income from shelter investments — in effect, removing the main reason for investing in a shelter.



$11 billion was invested in limited-partnership tax shelters in 1985.

In the hands of marketers, the term "tax shelter" has come to cover a lot of territory.

Now, after the hoopla surrounding the tax overhaul legislation, some promoters suggest that rumors of the death of tax shelters are exaggerated.

But in the true sense of the word, tax shelters are history.

"If they're not dead, they're a fraction of their former selves," said Paul Farber of the Richard A. Eisner accounting firm in New York City.

A tax shelter is designed to produce large losses on paper that an investor can deduct from ordinary income, like salary, interest and dividends, to reduce his tax bill — sometimes to zero.

Under the new law, though, you'll be able to deduct shelter losses only up to the amount of your income from similar so-called passive investments — those in which you take no active role. So if you don't have passive investments that make money for you, you lose the write-offs from your existing shelters over four years. New shelters lose right away.

Shelters typically are set up as limited partnerships to invest in assets that qualify for rapid depreciation allowances and tax credits. Popular shelters involve real estate, equipment leasing, oil and gas drilling, cattle feeding and, more recently, movie production.

The biggest tax breaks are in highly leveraged investments — those that borrow much of the cost of the assets. Reason: Although investors put up a fraction of the cost and borrow the rest, they get all the tax write-offs as if they had incurred all the costs.

Here's how a traditional tax shelter might work:

■ A group of investors — say, 40 — antes up $50,000 apiece to form a limited partnership.

■ The partnership takes the $2 million, borrows an additional $8 million and buys a $10 million computer, which it leases to a large company.

■ Most of the lease payments from the company are used to make payments on the loan — largely deductible interest in the early years — and cover the expenses of managing the partnership.

■ The partnership gets an investment tax credit of up to $1 million (up to 10% of the cost of the computer). Depreciation totals at least $1.3 million the first year.

■ The tax credit comes right off each investor's tax bill — $25,000 apiece. Depreciation is deducted from income — $32,500. Result: An investor in the 50% tax bracket cuts his taxes $41,250 ($25,000 from the credit, $16,250 from the depreciation) the first year.

■ Lease revenue and interest and management expense roughly cancel each other out.

An investor could get an even higher first-year return by borrowing much of his individual investment. Some partnerships arrange with banks to lend investors money. You might pay only $20,000 of your own money the first year but still get the $50,000 tax break.

A partnership typically lasts five years or more. The tax breaks get smaller in future years: The investment tax credit is used only once, interest write-offs decline and depreciation sometimes declines as well.

According to Robert A. Stanger & Co., which tracks investments in partnerships, shelter-oriented partnerships raised $11.5 billion in 1985.

But now Congress has changed the rules in a big way. First off, the new law eliminates the investment tax credit and stretches out the depreciation period on many assets. The size of a project's paper losses will be smaller.

In addition, investors won't be able to use losses from passive investments to offset ordinary income, such as wages, dividends and interest.

Goodbye, tax shelters. Hello, tax-advantaged investments.

Experts say that despite tightening of tax loopholes, many limited-partnership investments still have advantages for tax reasons — either because they produce tax-free income or because they defer income, and therefore taxes.

Partnerships designed solely to produce tax losses are being replaced by those that generate income as well as some tax breaks for investors.

"There are real economic gains to be made in real estate and equipment leasing," said tax expert Marc Levy of the accounting firm Ernst & Whinney. "The risk may be higher than investing in blue-chip stocks, but the potential return is higher."

Cable TV franchises are another growing area of interest for income-producing partnerships.

Here's how limited partnership sponsors can set up deals to make them more attractive: Instead of borrowing much of the money to purchase an asset, more partners are brought in. So instead of the income from lease payments going to pay off a loan, cash is paid out to investors. Depreciation still creates some paper losses. Result: Part of the cash payout is not taxable.

Such deals should be evaluated like any other investment — weighing risk, security and after-tax return.

Making the best of the tax shelter changes

Don't panic if you own a tax shelter. The situation might not be as bleak as it seems.

You're fairly safe if your investment was made before the date President Reagan signs the tax bill into law.

On those investments, you'll still be able to use 100% of your "passive" investment losses in 1986 to offset ordinary income. The amount drops to 65% in 1987, to 40% in 1988, 20% in 1989 and 10% in 1990. After that, passive losses can be used only to offset income from passive investments.

Unused losses can be carried forward to offset passive income in future years, and they can be applied to any gain when you sell your investment or the partnership closes out.

One strategy: Invest in income-producing passive investments so you have income against which to apply losses.

Marc Levy of accountants Ernst & Whinney cautions that not all limited partnerships are passive investments. Rental income from real estate is classified in the new law as passive (although the limit on write-offs is modified — most investors can deduct $25,000 from regular income). Income from a partnership that invested in financial assets such as stocks and bonds wouldn't be considered passive. In between, says Levy, is a gray area.

Experts urge that you rule out walking away from an investment on which you still owe money. You'd forfeit losses used to reduce your tax es in previous years — so you'd owe back taxes. Also, you're legally liable to the partnership.

— Neil Budde

Oil, gas investors remain undaunted

By Neil Budde
USA TODAY

Howard Hirsch, chairman of The Seville Group, which puts together oil and gas investments, isn't crying over the new tax law.

Sure, he says, drillers no longer get a 10% investment tax credit when they buy new drilling equipment. Also, part of the deduction for so-called intangible drilling costs will have to be added back into your income if you calculate the alternative minimum tax.

"But we have been relatively unhurt," Hirsch says.

The reason: Congress left a door open for the oil and gas industry. The new law allows investors with a "working interest" in oil and gas properties to continue to use losses to offset ordinary income.

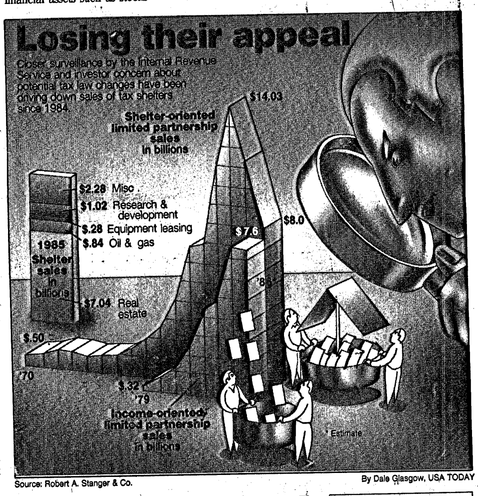
A working interest partnership can be structured like a limited partnership, but there is an important difference: Limited partners are not liable for more than their original investment, but working interest partners are responsible for anything that befalls the partnership.

If the partnership borrows against the production from one well to drill others, an explosion or other problem at the producing well could leave partners liable for repaying the loans.

But Hirsch says investors can be protected by insurance against a major loss. Investors also will have a "better comfort level" if they're dealing with a company with a good track record and one that is operating on an all-cash basis.

Fuhrman Nettles, vice president for marketing of Robert A. Stanger & Co., a partnership investment adviser, says that, after a few down years, "There seems to be a building interest in oil and gas drilling."

An investment this year could be attractive because most of the tax breaks from intangible drilling costs accrue in the first year, Nettles says. That allows you to reduce your income this year, when tax rates are still high, and reap any rewards under lower tax rates in the future.



Source: Robert A. Stanger & Co.

By Dale Glasgow, USA TODAY

Real estate investors lose ground

By David Landis
USA TODAY

Warren Angell's investment in a real estate tax shelter took a dive around midnight Aug. 16, when congressional negotiators agreed on details of a new tax law.

Last year, Angell invested $5,000 through a limited partnership that owns commercial buildings.

Rather than yielding dividends, the investment was supposed to yield deductions to reduce Angell's taxes on income from his office supplies business in Kansas City, Mo.

But now those deductions will be phased out by 1991, and Angell is left with an investment that yields nothing.

His stockbroker has offered to buy him out for $3,400. "If I sell today, I've lost 30% on it in one year," he says. "But I may just have to lick my wounds on this thing and go on to something else."

Angell is not alone. An estimated $17 billion was invested in real estate limited partnerships in 1985, says Ken Rosen, manager of real estate research at investment bankers Salomon Brothers Inc.

Here's how a real estate limited partnership works: The sponsor raises money from investors to buy properties — usually office buildings. Shares of those properties are allocated among the investors.

The sponsor, as the general partner, manages the investments and is paid a fee by the limited partners. The partners get a proportional share of the properties' income, if any. More important, they also get a share of its deductions.

Current law allows commercial property to be depreciated over 19 years. In theory, that means the owner could take a deduction equal to one-nineteenth the building's value each year.

But the law also allows for "accelerated" depreciation, meaning an owner can choose to take more of the deduction in the early years of ownership — almost twice as much. Because the owners may have put down as little as 5% or 10% of the purchase price (and borrowed the rest), an owner's depreciation deduction each year may exceed his investment.

Limited partnerships generally last as long as the big deductions hold out. Once they're exhausted, the properties typically are sold.

Two provisions of the new tax law make depreciation less lucrative: It will be stretched out over 31½ years for most commercial buildings, and accelerated depreciation for real estate is ended.

More important, the law phases out the investors' ability to use partnership losses to offset income from other sources. That means the end of partnerships formed strictly as tax shelters.

Many investors, deprived of their write-offs, "will have to bite the bullet," says Walter Danley, former vice president of Consolidated Capital Equities Corp. Those who invested on the installment plan are contractually bound to keep making payments into the syndicate without getting any offsetting benefits.

There are techniques to mitigate your losses:

■ Losses from tax shelter partnerships still are useful if matched against income from investments in partnerships.

Or, your sponsor could do that for you. A sponsor who has both income- and tax shelter-oriented partnerships can roll them into a master limited partnership in which you could invest. That way, there would be some income with which to balance losses.

■ Many investors will be considering two unpleasant options — defaulting on the payments due and thus damaging their credit ratings, or pouring more cash into what they know is a money-losing investment.

New laws give boost to REITs

Not all real estate investments were blitzed by tax revision. Real estate investment trusts were unscathed.

REITs invest in income-producing real estate. Shares are traded like stocks, at prices generally ranging from $5 to $50.

There are 136 REITs in the USA with $17.5 billion in assets, according to the National Association of Real Estate Investment Trusts.

REITs can offer better dividends than many stocks because they distribute 95% of earnings to shareholders, so they avoid paying corporate taxes.

For the five years ending Dec. 31, 1985, the association's index showed a cumulative return (dividends and appreciation) of 111.05%, vs. 90.46% on the Dow Jones industrial average.

The new tax law loosens restrictions on REITs as developers. It also gives them a more direct role in managing property.

"The REIT has been suffering a serious competitive disadvantage," says Mark Decker of the REIT association. "We no longer have to fight to keep our noses above water."

— David Landis

Low-income housing grabs limelight

By William Giese
USA TODAY

Tax overhaul includes a whopper of a new tax break for people who invest in low-income housing projects.

Starting in 1987, investors in low-income housing construction or rehabilitation can get up to a 9% tax credit every year for 10 years.

If you invested $10,000, you would reduce your tax bill by $900 each year for 10 years. That's $9,000 back on your $10,000 investment — on top of deductions like depreciation and any rental income you might collect.

"This could be one of the few tax shelters left under the new tax plan," says Marc Levy of the accounting firm Ernst & Whinney.

The reason for the break? Low-income housing projects produce low rental income, and that leaves investors cold.

Currently, there is no such credit; low-income housing investors get other tax incentives, such as faster depreciation. The credit replaces those breaks.

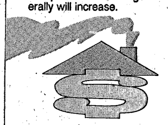
TAX PLANNING: PAYING FOR PROPERTY

Second homes lose their money-making appeal

By David Landis
USA TODAY

What's changing:
Deductibility of real estate investments.

What it means:
Many real estate investments, including renting out second homes, will be less profitable. Rents generally will increase.



We own 4.5 million second homes.

Donald Mash had been thinking about buying a $65,000 second home in the western Pennsylvania resort of Seven Springs. But late in the summer he started having second thoughts because the new tax law made it less affordable.

If he had intended to use his home solely as a vacation spot, the new law would have meant little.

But, "I was looking for an investment as well as some pleasure on it" says Mash, 43, vice president for administration at George Mason University in Fairfax, Va.

A vacation home is just like your first home. It still would yield the same deductions as a primary residence — mortgage interest and property taxes.

The new law would do little to curb the basic benefits of home ownership — although the deductions would not be worth as much. That's because the top marginal tax rate will be reduced from 50% to 38.5% in 1987, and 28% after that, for all but the highest-income taxpayers.

Mash says that didn't bother him, although he and his wife, Julie, a computer firm marketing manager, are in a tax bracket "in the 40s."

The biggest change in the cost of second-home ownership is that reduced deductions make the decision to buy and rent out a second home to cut costs less appealing.

The law will cut back the depreciation deductions for a second home that is used as rental property. A house can be classified as rental property if the owner uses it no more than 14 days a year or 10% of the time it is rented out, whichever is more.

The Mashes wanted a one-bedroom condo to use a few weekends a year and otherwise rent out. They figured they could get as much as $500 to $600 a week during the busy skiing season.

After the Mashes made a 20% down payment, the mortgage payments on a $52,000, 30-year fixed-rate mortgage at 10% interest would be $5,476 a year (principal and interest).

Under current law, the depreciation deduction would have reduced their taxable income by almost $6,000 in the first year. So the depreciation deduction would have offset much of the mortgage payments. The rental income would have covered the annual costs of utilities, insurance, maintenance and condo fees.

Bottom line: With rental income and tax deductions offsetting annual costs, the Mashes would have gotten a vacation home for very little a year. But that was before the federal tax overhaul.

The new law lengthens the depreciation schedule to 27½ years from the current 19 years and ends accelerated depreciation, which allows a bigger share of the deduction for depreciation to be taken during the early years of ownership.

Those changes would cut the depreciation deduction in the first seven years by more than half — from $31,802 under current law to $16,449.

"There's no question that it would not be as good an investment now," Mash says. So the house in Seven Springs is off.

Although it would not affect the Mashes, the new tax law also will cap the amount of rental property deductions used to offset non-rental income, including wages, at $25,000 a year — and that amount shrinks for upper-income taxpayers. The $25,000 deduction starts to be phased out for taxpayers — singles or couples — with an adjusted gross income of $100,000; by $150,000, no deduction is allowed. (For the purposes of this rule, adjusted gross income is calculated without considering certain other losses, individual retirement account deductions or taxable Social Security benefits.)

"The thing (tax revision) has done is create a lot of different things to think about," says Mash. "For the average guy, it has a tendency to paralyze you."

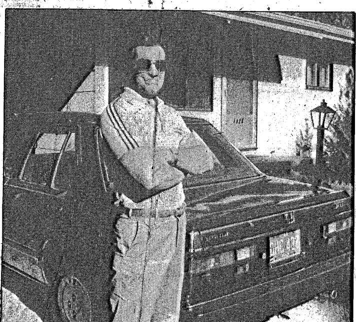
That's why some experts think home sales will cool off, even though the house itself — not tax deductions — is usually a home buyer's primary motivation.

One thing tax revision has done for homeowners is make home equity the only source of tax-deductible borrowing for consumer purchases.

It eliminates most interest deductions for personal borrowing, but home equity is a loophole.

The new law allows homeowners to deduct interest on home-secured loans, no matter how the money is spent, up to certain limits.

For mortgages taken out before Aug. 16, 1986 — the day the House-Senate compromise was approved by a conference committee — interest remains deductible on loans up to the market value of the home. But there's a strict limit for new loans: Interest may be deducted on loans that total no more than the original purchase price plus the cost of any home improvements.



By Bob Modersohn

HIT HARD: West Des Moines, Iowa, landlord Jim Theisen, in front of one of his 30 rental properties, expects to lose $150,000 in deductions.

Landlords will pay, so tenants will, too

By David Landis
USA TODAY

The new tax law is going to cost landlord Jim Theisen of West Des Moines, Iowa. It's going to cost his tenants, too.

Theisen loses about $150,000 in annual deductions from the 30 houses he owns and rents out. He figures his monthly rents, which now range from $325 to $600, will have to go up 10% to 20% to make up for the loss.

How much they actually go up depends on demand, which is brisk now, Theisen says. All his houses are rented. He expects demand to get even better as the loss of tax deductions dries up new investment in construction of rental property.

"There's going to be a lot of selling of real estate, and you won't see as many (rental units) built," he says. "Eventually, demand is going to be greater — probably in a year or so. I do see rents increasing."

Under current law, rental property that shows a loss on paper can pay off. Deductions for depreciation, taxes, mortgage interest, maintenance, utilities and insurance can outstrip rental income, and the losses can be used to offset income from wages and other investments.

But the new law has some features landlords don't like — a less generous depreciation schedule, limits on the amount of paper losses that can be used as deductions, and elimination of a special low tax rate on capital gains for property sold after more than six months of ownership.

Depreciation is a deduction for the value an asset theoretically loses each year.

Current law allows rental buildings to be depreciated over 19 years. In theory, that means the owner could take a deduction equal to one-nineteenth of the building's value each year. But the law also allows "accelerated" depreciation, meaning an owner can take a greater share of the deduction in the early years of ownership — almost twice as large as one-nineteenth.

The new tax law will make depreciation less lucrative by ending acceleration for residential property and stretching depreciation over 27½ years for rental housing.

Deductions for rental losses (including depreciation) will be limited to the amount of rental income, plus another $25,000 for those who actively manage their properties. That extra $25,000 applies only to taxpayers with adjusted gross incomes of less than $100,000. It is phased out for those with adjusted gross incomes between $100,000 and $150,000.

Also less favorable: taxes on long-term capital gains (profits on the sale of property owned more than six months). Currently, 60% of long-term capital gains is not taxed. Under the new law, 100% of long-term capital gains is taxed as ordinary income, up to a top rate of 28%.

The National Apartment Association, an owners group, predicts rental property values will fall 28% over the next two years.

A lot of that is due to the effect on real estate limited partnerships that finance construction of apartment buildings. Partnerships become far less attractive to investors under the new rules.

But the law doesn't come down so hard on mom and pop landlords who own just a few rental units and don't have large incomes to shelter.

Industry experts say rents will have to make up for the loss of tax breaks. But that won't be the only thing pressuring rents upward.

As apartments become a less desirable investment, new construction will drop, tightening the supply. The National Apartment Association says multifamily housing starts will drop to around 385,000 in 1987, compared with 516,000 units in 1985 and 473,000 in 1986.

The association sees rents rising in some areas by 22% by 1988. The National Association of Home Builders predicts a 15% to 20% rise. The USA's 60 million renters — 35% of all households — pay a median rent of $356 a month.

Many areas, particularly in the Sun Belt, have too many apartments to let rents rise much. In those places, some fear, owners will default and "give their keys back to the bank," says Colleen Fisher, governmental relations director of the National Apartment Association.

Real estate: taxing times ahead

Tax overhaul promises to turn the real estate industry inside out by limiting the tax loss deductions that made real estate such a lucrative tax shelter.

The effects, in the opinion of experts:

■ Mortgage interest deductions remain for first and second homes, but with tax rates lower the deductions won't be as beneficial. Home sales will fall slightly, and the median price will rise less than it did this year.

■ Partnerships put together to invest in real estate, if they were intended only as tax shelters, will dry up because the tax write-offs are restricted.

■ Rental housing, now abundant, will become less plentiful. Landlords will see their costs rise, and that means rent increases for the one-third of USA families that don't own homes.

■ Construction of almost everything except single-family homes will decline.

— David Landis

TAX PLANNING: LOOKING DOWN THE ROAD

TAXLINE ON PLANNING

ANSWERS TO YOUR QUESTIONS ABOUT THE NEW TAX LAW

Will municipal bonds still be tax-free?
— D.L., Marion, Ohio

Yes. Municipal bond income will be exempt from regular federal income tax, with an exception: Income from private-purpose municipal bonds issued after Aug. 7, 1986, such as those used by states to fund student loan programs, will be tax-free unless you are required to pay the alternative minimum tax. In that case, the income will be figured in with your other income when calculating the 21% AMT, which is there to keep people from reducing their taxes to little or nothing using legitimate tax write-offs.

How will employer-sponsored 401(k) retirement savings plans be affected?
— D.P., Newark, Calif.

The maximum you can put into a 401(k) each year is reduced. Under current law, the maximum from employer and employee is $30,000 a year — split up any way you like. Under the new law, the total is still $30,000, but the employee contribution is limited to $7,000. Because the new rule will affect contributions made beginning in 1987, financial advisers say it is a good idea to fund your 401(k) as heavily as possible before the end of the year. Another important change: All withdrawals (except those used to pay certain medical expenses) before age 59½ will be subject to a 10% penalty in addition to the regular tax owed.

Five years ago I purchased a tax-deferred annuity. Will annuities be taxed immediately?
— W.T., Clinton, Tenn.

No. Annuities, usually sold by insurance companies, guarantee you future payments in exchange for an investment now. Taxes on annuity income are deferred until you start receiving payments down the road. People who hold annuities shouldn't have a problem with the new law.

People who have worked for a company five years or more — will they be vested in pension plans?
— R.R., Battle Creek, Mich.

They could be. You'll have a better chance at vesting after five years under the new rules. Workers are vested when they have worked for an employer long enough to be guaranteed a pension. Currently, employers have three choices — vesting workers 100% for a full pension after 10 years, vesting them in increasing percentages for partial pensions between the fifth and 15th years, or vesting in increasing percentages based on age and years worked. The new tax law has new vesting rules that take effect Jan. 1, 1989. Workers must be fully vested after the fifth year, or vested in stages between the third and seventh years. So if you've worked for a company with a pension plan for five years as of Jan. 1, 1989, you'll be at least partially vested.

Any change in how federal pensions are taxed?
— D.C., Olympia, Wash.

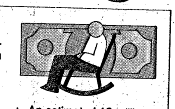
Yes. Under current law, retired federal workers do not pay tax on pension benefits until they have received in benefits the amount they paid into the system. Under the new law, if you retired after July 1, 1986, you'll pay tax on a portion of every check under a formula based on how much you contributed.

Long-term investing regains balance

By Jim Henderson
USA TODAY

What's changing:
Pension vesting rules; formula for taxing lump-sum payments.

What it means:
Employees will be guaranteed pensions faster; tax on lump sums may be higher.



An estimated 15 million people receive pension benefits.

The new tax law promises to change for the better the way we make our long-term investment decisions. We'll be worrying a lot less about taxes and a lot more about the economic soundness of our investments.

"It looks like I'll have to stop doing what I've been doing and start learning about traditional investments," says Lanny Specht, 38, of Savage, Md.

For years Specht's investment strategy has depended on the favorable tax treatment of long-term capital gains. He buys small pieces of real estate in areas where they're likely to appreciate in value over a short time, then sells them after the long-term capital gains holding period, currently six months. Only 40% of a long-term gain is taxed.

At his current 33% marginal tax rate, that means he pays 13.2% tax on the profit. Under the new law his profit will be taxed at 28%. "It pays at 13.2%," he says, "but it's not worth the risk at 28%."

Despite the lost tax breaks for capital gains, "There will still be a lot of tax strategies you can use," says Lewis Walker of financial planners Walker Cogswell & Co. in Atlanta, Ga.

The law will drop the top individual tax rate to 28% from 50% by 1988, but most taxpayers will see little change in their tax bills. So investing with an eye toward maximizing your after-tax returns will be no less crucial.

"For example, the magic of tax-deferred compounding will be just as valid," Walker says. "So such things as IRAs and 401(k) retirement plans will be just as important as ever."

Although the law will reduce or eliminate deductions for IRA contributions for many taxpayers, it doesn't prohibit putting money into IRAs. And regardless of whether the contributions are deducted, earnings in an IRA will continue to grow tax-deferred.

The law also reduces to $7,000 from $30,000 the maximum employees can contribute each year to a company-sponsored 401(k) retirement savings plan. The contributions still are tax-deductible, and the money still grows tax-deferred.

There will, however, be changes in the attractiveness of certain types of investments:

■ Growth investments, such as stocks in young companies expected to grow in value without producing dividend income, will not be as highly favored under the new rules. Reasons: Long-term gains will be fully taxed. Granted, the new law's lower tax rates will lessen the blow, but the bottom line in most cases is you'll pay more tax on a long-term gain.

■ Income-oriented investments, such as bank certificates of deposit or high dividend-paying stocks, will become more attractive. Reason: You'll get to keep more of the income after taxes thanks to the new law's lower tax rates.

The most attractive long-term investments now may be hybrids that provide both growth and income, says Robert Martel, president of Financial Planning & Management in Lexington, Mass. Examples:

■ Convertible bonds — corporate bonds that pay interest and can be converted to shares of common stock, so their value rises with the company's stock price.

■ High dividend-paying stocks. Favorite industries: utilities, telephone and oil.

■ Balanced mutual funds, which always keep portions of their portfolios in stocks and bonds.

■ Equity income mutual funds, which can invest in stocks or bonds as the fund manager sees fit.

"The key is to use an investment that will give you a one-way ratchet effect," says Martel. "When the stock market is rising, the investment will rise, and when the stock market is falling, the income will keep the investment from falling."

Another area of growth and income for long-term investors is real estate. True, the tax law will wipe out tax shelter programs. "But owning a piece of rental property will become the average guy's tax shelter," Walker says.

Under the law, if your adjusted gross income is less than $100,000, you'll be allowed to use up to $25,000 in losses from rental real estate that you own and manage to offset your regular income. If your adjusted gross income is above $100,000, that $25,000 will be phased out; you will not be able to take any losses if your adjusted gross income is above $150,000.

"That $25,000 limit provides an awful lot of shelter, but you'd also want the property to have some near-term potential for a positive cash flow so that you'll be able to get income from rents and growth potential on the appreciation of the property," Walker says.

For those who don't want to be landlords, income-oriented real estate limited partnerships are the best real estate investment, says financial planner Lynn Hopewell of Hopewell Rembert Advisors Inc. in Falls Church, Va.

By Mark Angeles, USA TODAY

FAMILY PLAN: Lanny and Linda Specht of Savage, Md., with children Joshua, 2, and Keisha, 11, are restructuring their long-range investment plans.

Alternate routes for tax breaks

Now that the plug has been pulled on most tax shelters, existing tax-free and tax-deferred investments bear a closer look.

Some to consider:

■ Tax-free municipal bonds — the last vestige of tax-free income. Experts say there are opportunities for short-term profits because the demand will cause yields to fall, making yields available today look even more attractive. That will push up bond prices.

Residents of states with state income tax should look at muni bonds issued in their state. For residents, the interest on instate bonds is free of state as well as federal income taxes.

■ Tax-deferred annuities that are offered through insurance companies.

Annuities generally come in two forms: guaranteed and variable.

A guaranteed annuity means the insurance company guarantees to pay you a set interest rate. The rate usually is adjusted every one or three years. A variable annuity lets you choose where the money is invested, usually from a menu of mutual funds. Because the investment is in an annuity, all the earnings are tax-deferred until withdrawn.

But there are early-withdrawal penalties on annuities. And the IRS will impose a 10% penalty on earnings taken out before age 59½.

"So before you jump into an investment just because the tax laws have changed," says financial planner Robert Martel of Financial Planning & Management Inc., "find out how much it will cost you in both fees and lost flexibility."

— Jim Henderson

Defer to avoid lump-sum bite

By William Giese
USA TODAY

A worker who leaves a job with a fat check from a pension plan may be taking some extra lumps beginning next year because of the new tax law.

Of 49.9 million USA workers covered by pensions at work, about 9.6 million already have earned the right to take their money in a lump sum if they left the job right now, before retirement; 12.5 million workers will be eligible to receive a lump sum when they retire.

Under current rules, a worker who gets such a cash payment is eligible to defer all the taxes by putting the money into an individual retirement account, or to take the money but reduce the taxes by using 10-year forward averaging.

The details:

■ You can roll the entire lump sum into an IRA within 60 days of receiving it. Taxes are deferred until you begin withdrawals after age 59½. (Withdraw earlier than 59½, and you'll pay a 10% penalty plus income tax on the amount withdrawn.)

■ If you decide to take the money rather than salt it away, you're eligible for 10-year forward averaging. With that break, you figure what your tax would be on one-tenth of the lump sum (ignoring your other income) and then multiply by 10.

You benefit two ways: By excluding other income, you stay in a low tax bracket; and by using a tax rate that applies to the smaller amount, you are taxed at lower rates.

Under current law, those tax breaks are available on lump-sum pension payments received when you are 59½ or older, become disabled or leave your job. You can use averaging as often as you like over the course of your career before age 59½ and once after 59½.

Starting next year, the rules will change: 10-year averaging drops to five years, and that reduces the tax savings. Also, you'll be allowed to average once and only after age 59½.

But there is an exception: Taxpayers who are 50 or older before Jan. 1, 1986, can choose either five-year averaging based on tax rates in the year they take the lump sum or 10-year averaging anytime, but at 1986 tax rates.

If you're in that group and take your payment before 59½, you still would be subject to the 10% penalty, says Peter Elinsky, retirement and tax specialist with accounting firm Peat, Marwick, Mitchell & Co.

If you are under 59½ and have the option of taking your lump sum this year or next, consider taking the money this year, says Elinsky.

Your basic investment decision is between 10-year averaging and an IRA rollover.

Elinsky says you will almost always be better off taking 10-year averaging under current rates than five-year averaging at the new tax rates. (An exception is very large lump sums — say, around $1 million — says Peat Marwick tax expert Deborah Walker. Because such large payments are taxed at this year's top 50% rate even with 10-year averaging, you'd fare better with five-year averaging.)

When debating an IRA rollover vs. 10-year averaging, it's a question of when you'll need the money, says Elinsky. "The easy answer is, the longer you can keep it in an IRA, the better off you are."

Elinsky cites as an example a 60-year-old worker who changes jobs this year and receives a lump sum of $100,000.

Assuming he wouldn't take the money out for at least six years, an IRA is better. The worker will end up with more after-tax cash by letting the IRA build up untaxed than by using 10-year averaging.

However, if he expects to need the cash within six years, the worker is better off taking 10-year averaging in 1986 and investing the after-tax cash.

So, if the worker can keep it socked away for six years or more, an IRA rollover is better.

Pension planning

This year, anyone who receives a lump-sum pension payment can roll it over into a tax-deferred IRA or be taxed on the lump sum using a tax-reducing calculation called 10-year averaging. Starting next year, people with lump-sum pension payments who were 50 or older before Jan. 1, 1986, can roll the money over into an IRA or choose between five- or 10-year averaging.

This year's options

For a $100,000 pension payment received in 1986, here's a year-by-year comparison of how you'd fare rolling it into an IRA earning 9% vs. paying taxes using 10-year averaging and then investing.

Year	After-tax[1] cash from: IRA	10-yr. averaging[2]	IRA advantage (disadvantage)
1986	$73,080	$85,961	($12,881)
1987	$79,657	$91,119	($11,462)
1988	$86,826	$96,586	($9,760)
1989	$94,641	$102,381	($7,740)
1990	$103,158	$108,524	($5,366)
1991	$112,443	$115,035	($2,593)
1992	$122,562	$121,937	$625
1993	$133,593	$129,254	$4,339
1994	$145,616	$137,009	$8,608
1999	$221,268	$183,349	$37,920

1 — Assumes you withdrew your IRA completely and paid taxes on the amount at a 28% rate.
2 — Assumes taxes are paid on a $100,000 lump-sum payment in 1986 using 10-year averaging and funds then are invested at a 6% after-tax rate of return.
Source: Peat, Marwick, Mitchell & Co.

Next year's options

For a $100,000 pension payment received in 1987, here's a year-by-year comparison of how you'd fare rolling the money into an IRA earning 9% vs. using 10-year or five-year averaging.

Year	After-tax cash from IRA[1]	10-yr. averaging[2]	5-yr. averaging[2]
1987	$77,940	$89,791	$87,860
1988	$84,955	$95,179	$93,132
1989	$92,601	$100,889	$98,720
1990	$100,935	$106,943	$104,643
1991	$110,019	$113,359	$110,922
1992	$119,920	$120,161	$117,577
1993	$130,713	$127,370	$124,632
1994	$142,477	$135,013	$132,110
1995	$155,300	$143,113	$140,036
1999	$217,766	$180,677	$176,792

1 — Assumes you withdrew your IRA completely and paid taxes on the amount at a 28% rate.
2 — Assumes taxes are paid on a $100,000 lump-sum payment in 1987 using 10-year or five-year averaging; funds then are invested through year's end at a 6% after-tax rate of return.
Source: Peat, Marwick, Mitchell & Co.

USA TODAY

TAX PLANNING: RETHINKING YOUR STOCKS

TAXLINE ON CAPITAL GAINS

ANSWERS TO YOUR QUESTIONS ABOUT THE NEW TAX LAW

What are the individual capital gains tax rates for 1987 and 1988?
— D.C., Corona, Calif.

Starting in 1988, when the new 15% and 28% individual tax rates take effect, long-term capital gains — profits on investments held more than six months — will be taxed as ordinary income. In the 1987 transition year, the top long-term capital gains rate will be 28%, even though the top 1987 individual rate will be 38.5%.

If I sell a stock this year to take advantage of current capital gains tax rates, and buy the stock back again, do I need to wait 30 days after the sale?
— H.N., Memphis, Tenn.

No. If you show a profit on your stock sale, you can buy back the same shares immediately. However, if you have a loss, you must wait 30 days before buying back the shares. That is the rule now and it won't change under tax overhaul.

What are the main changes for business taxes?
— T.T., Baltimore, Md.

Businesses will pay more — an additional estimated $120 billion in taxes during the next five years. Here are some of those changes:

The top corporate tax rate will drop from 46% to 34% by 1988. Depreciation write-offs for many types of equipment will take longer — five years instead of three, for example, for company cars. But there will be bigger depreciation write-offs in the early years. The maximum 10% investment tax credit for business equipment purchases is no longer available after Dec. 31, 1985, unless you have a signed contract by that date.

Capital gains will be taxed like ordinary corporate income with a maximum 34% rate; currently, long-term capital gains are taxed at a maximum 28%. Dividends received by corporations from their investments will be 80% excluded from taxation, compared with the current 85%. The 25% research and development credit will be cut to 20%.

The three-martini business lunch will be cut back to 2.4 martinis. Business meals and entertainment, now fully deductible, would be only 80% deductible.

Will the bill affect Subchapter S corporations?
— J.E., Tucker, Ga.

It will make them more attractive. A Subchapter S corporation is like a partnership; profits are taxed directly to the owners. No corporate income tax is paid. To qualify for Subchapter S tax treatment, a company must have 35 or fewer stockholders. Tax experts predict many corporations will switch to Subchapter S status. That's because the top 34% corporate tax rates would be higher than the top 28% individual rates after 1987.

How the new law cuts into your gains

Here's one example of how to evaluate the effect the new tax law will have on long-term capital gains. Say you bought 100 shares of Owens Corning Fiberglas on Jan. 2, 1986, at $37½. It recently traded at $77½. Brokerage fees: 1.5%. Here are the after-tax gains this year for a taxpayer at the 38% marginal tax bracket (middle-income taxpayer) and the 50% marginal tax bracket (the highest rate), and next year at the 28% marginal tax bracket (a new top rate likely to include middle-income and up):

Marginal tax bracket	1986 38%	1986 50%	1987 28%
Sale price	$7,750	$7,750	$7,750
Brokerage fees	$173	$173	$173
Net sale proceeds	$7,577	$7,577	$7,577
Purchase price	–$3,750	–$3,750	–$3,750
Pretax capital gain	**$3,827**	**$3,827**	**$3,827**
Taxable amount	$1,530[1]	$1,530[1]	$3,827[1]
Tax	$581	$765	$1,072
After-tax gain	**$3,246**	**$3,062**	**$2,755**

1 — In 1986, only 40% of long-term gain is taxable. In 1987, all gains are taxable.
Source: Coopers & Lybrand

Juggle capital loss to your advantage

By Anne Kates
USA TODAY

The new law requires some pencil work to figure out whether it's best to take your capital losses now — or wait until next year.

Taxpayers still can reduce their tax bite by writing off capital losses against capital gains.

If your losses exceed your gains, you can use the losses to reduce ordinary income, such as wages, by as much as $3,000 a year. If you have more than $3,000 in losses, you can carry over the extra amount to reduce income the next year, until your losses are used up.

Under the old law, you could write off 50 cents of ordinary income for each $1 in long-term losses. Short-term losses could reduce the income dollar for dollar.

The new law removes the distinction between short-term and long-term losses. Each can write off ordinary income dollar for dollar. The $3,000 yearly cap still holds, and you still can carry over unused losses.

When to use losses to help reduce income:

■ If you expect to have enough long-term losses to be able to write them off against ordinary income, wait until next year. You'd need $8,000 in long-term losses this year to get the full $3,000 reduction in your taxable income; $3,000 in losses would accomplish the same thing next year.

■ Use short-term losses this year to reduce ordinary income. Each $1 of short-term losses erases $1 in income, remember, and that $1 deduction is worth more this year when income is taxed at higher rates. Next year's lower tax rates will make your losses less valuable.

When to use losses to reduce capital gains:

■ Take capital losses this year if you have short-term capital gains. Short-term gains, taxed at the same rate as ordinary income, carry a top 50% rate this year, 38.5% next year and 28% or 33% in 1988 and thereafter. So each dollar you shave off your short-term gain saves you up to 50 cents in taxes this year, 38.5 cents next year and only 33 cents thereafter.

■ If you expect capital gains next year, defer capital losses that aren't needed to offset short-term gains this year. Only 40% of long-term capital gains are taxed now, so if you're in the 50% tax bracket, the most tax you'd pay on long-term capital gains this year would be 20%. That means you shave a maximum of 20 cents per $1 from your capital gains tax bill by deducting losses from long-term gains this year. You'd save even less in a lower tax bracket.

But next year, when long-term gains are taxed the same as ordinary income, you could shave up to 28 cents on the dollar off your capital gains tax bill; in 1988 and thereafter, you'd save up to 33 cents.

Hold or sell? Gains tax tips scale

By Anne Kates
USA TODAY

Sheldon Berger and his wife, Judy Poltz, sold all their stock in mid-September and put the proceeds in a money market account. The reason: Taxes.

The bull market has been good to psychologist Berger, 37, and lawyer Poltz, 38, of Peoria, Ill. But they bowed out now because the new tax law will levy higher capital gains taxes.

Now, you pay taxes on only 40% of long-term capital gains — gains on investments held more than six months. So someone in the top 50% marginal tax bracket pays 20%.

The new law erases the distinction between short- and long-term capital gains. After Dec. 31, all capital gains will be taxed at the same rates as ordinary income, such as wages and dividends. The top rate will be 28% in the 1987 transition year (an exception to the top individual rate of 38.5%) and 28% or 33% in 1988.

Of course, only the wealthiest people pay a 20% gains tax now. The jump to 28% is even more dramatic for people like Berger and Poltz. In their 42% tax bracket, they pay 16.8% on capital gains (42% of 40%).

The case for selling: If you don't think your stock is going to go much higher, sell now to lock in tax savings, some experts advise. That's what Berger and Poltz did. A combined income of about $50,000, plus $47,791 in capital gains, puts them in the 42% marginal tax bracket for joint filers. So they will pay $8,029 in taxes on capital gains this year. A 28% rate next year would raise the tax to $13,381.

For many investors, "The difference in tax is so significant, it makes economic sense" to sell, says Coopers & Lybrand accountant Pamela Pecarich.

Berger and Poltz had to weigh the tax advantage of selling this year against the chance of missing out on another stock surge next year.

"Even if the market doubled (our profits), we'd come out about even if we held onto the stocks," Berger says.

Because Berger sold all his stocks at once, he was able to negotiate a 20% discount on commissions. He paid $3,000 on a $209,000 sale, a 1.4% rate.

The case for holding: If you want your stocks for the long-term, it makes sense to hold them rather than selling them to take advantage of lower taxes and then buying them back. Reason: If you pay taxes and commissions from proceeds of the stock sale, you have that much less to reinvest, so you lose some earning power.

Most experts advise the approach taken by Wakefield, Mass., retiree William Clark. Because Clark is in the 30% marginal tax bracket, his capital gains tax rate will more than double, to 28% from 12%.

After reviewing his portfolio, Clark sold shares in only one mutual fund, an international fund, that invests in foreign stocks. The fund has prospered as the dollar has fallen, but Clark thinks the dollar is near its low — enough to prompt him to sell. Tax changes make it "timely to sell this year."

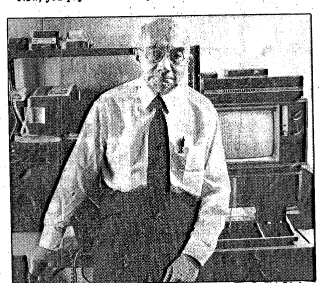
Clark thinks his other funds still are good long-term investments. Even if he sold the ones he likes and bought them right back, "It would be a wash. I'd pay lower taxes, but I'd have less income because I'd have less invested after the sale."

Some rules of thumb:

■ James Conley, a partner at accounting firm Arthur Young & Co., says if you sell your stock and then buy it back this year, the new stock would have to rise 56% before you'd make up for taxes paid and lost earnings.

■ But don't forget commissions, says Pecarich. If commissions equal less than 15% of the gain, that type of strategy may be worthwhile.

■ Short-term gains should be left alone. Because short-term gains are taxed at the same rate as ordinary income, wait for lower tax rates — 38.5% next year and 28% or 33% in 1988.

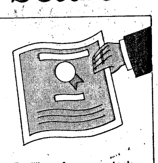


By Rick Friedman

HOLDING FAST: Wakefield, Mass., retiree William Clark will hang on to his investment portfolio despite capital gains increase.

What's changing:
Favorable treatment for long-term capital gains — only 40% of gains taxed, so top rate for someone in 50% marginal tax bracket is 20%.

What it means:
Long-term capital gains will be taxed as ordinary income. Rates: 15%, 28% or 33%.



47 million of us own stock.

RETIREMENT ACCOUNTS

For many, IRAs lose their luster

By Jesus Sanchez
USA TODAY

What's changing:
Deductibility of IRAs.
What it means:
Workers' IRA deductions will be limited if they are covered by retirement plans at work and have more than a certain income.

In 1984, taxpayers claimed IRA deductions on 15.2 million returns.

The new tax system will make life a bit more complicated for many of the 40 million people who have individual retirement accounts.

Under the old tax code, a working person could make a tax-deductible contribution of up to $2,000 a year to an IRA, and a non-working spouse could chip in $250. The IRA's earnings wouldn't be taxed until withdrawn.

The rules remain the same for those not covered by company pension plans. But new IRA rules, which take effect in 1987 for taxes due April 15, 1988, await the rest of us:

■ If you or your spouse are eligible to be in a pension plan at work, the IRA deduction could be reduced or eliminated for both of you.

A couple with an adjusted gross income under $40,000 still could deduct the $2,000 for each wage earner and $250 for a non-working spouse. But for couples with incomes between $40,000 and $50,000, the deduction is phased out. Couples with incomes above $50,000 lose the deduction.

A couple can't beat the system by filing separately. The phase-out comes between zero and $10,000 for married people who are filing separately.

A single taxpayer with a company pension won't lose the $2,000 deduction if adjusted gross income is below $25,000, but it is phased out between $25,000 and $35,000.

■ If you make non-deductible IRA contributions, withdrawals will be tricky. Deductible contributions must be kept in separate accounts from contributions that weren't tax-deductible. When making a withdrawal, you'll have to determine what percentage of your IRA balance was funded with deductible contributions as well as with non-deductible contributions.

Say 10% of all your IRA money was non-deductible. The rest consists of earnings and deductible contributions. You'll be taxed on 90% of the amount withdrawn — even if it is from an IRA funded with non-deductible, after-tax dollars.

The new code limits only deductibility of IRA contributions — earnings remain untaxed until you start making withdrawals at retirement.

A new fork in the road

Let income dictate your IRA strategy

By Jesus Sanchez
USA TODAY

Staying in

By Brian W. Robb
ON COURSE: Helicopter pilot Philip Massicotte, wife Cynthia will still put savings into IRA.

Getting out

By Steven Purcell
CAUGHT IN SWITCH: Kenton and Marlene Lynne will go to savings plan at work.

Tightening of individual retirement account rules will cost Kenton and Marlene Lynne of Rochester, Minn., their $4,000-a-year IRA deduction.

That's because he has a company pension plan, and they make too much money to be allowed to take the deduction.

So Kenton, 33, a computer systems programmer, and Marlene, 33, a surgical technician, will look at joining tax-deductible savings plans at work.

But the changes in IRA deductibility don't affect helicopter pilot Philip Massicotte, 48, and his wife, Cynthia, 38, a nurse. The Massicottes, who live in Bend, Ore., are not covered by a company pension plan, so they can continue deducting IRA contributions as they've been doing since 1982.

"I'm glad they did not do away with IRAs," says Philip. "It's the only way little people can get a retirement plan for themselves."

Even if you lose all or part of your IRA deduction, tax and investment experts say IRAs will continue to be attractive.

Interest and earnings still grow tax-free until you start making withdrawals.

"I will definitely recommend IRAs to my clients, since earnings remain sheltered from tax," says William Kovacic, president of Kovacic & Associates, a financial planning firm in Hickory Hills, Ill. His clients find IRAs an easy way to budget for their retirement.

Experts urge investors to put as much cash as they can into IRAs during 1986 — the last year before restrictions on deductions take effect. Contributions for 1986 will be acceptable up to the April 15, 1987, tax deadline, says Albert Ellentuck, national tax partner at accountants Laventhol & Horwath in Washington, D.C.

Where people invest their IRA money probably won't change. "Investment strategy will still come down to the risk people are willing to take with their retirement money," says George Barbee, executive director of Consumer Financial Institute in Newton, Mass., a division of accounting firm Price Waterhouse.

High-income investors might adjust their IRA portfolios because of the less favorable tax treatment for capital gains.

"People who will be affected by the higher capital gains tax for non-sheltered investments might want to use IRAs to trade stocks and mutual funds," suggests Karen Imhoff, editor of *The IRA Reporter*, an industry newsletter in Cleveland.

New option: Go for gold

By James Cox
USA TODAY

When Congress made individual retirement accounts an option for all USA workers in 1982, it bumped collectibles from the list of assets in which you could invest your IRA money.

The new tax plan won't open the IRA door to most collectibles — art, stamps or dolls, for example. But as of Jan. 1, you can deposit new U.S.-minted gold and silver coins in your IRA.

"Lots of people believe in gold," says Don Underwood, vice president and manager of retirement-plan marketing at Merrill Lynch & Co.

"I think we could have better ideas for investments, but if that's what (people) want, we'll get it."

There are hitches:

■ Only American Eagle bullion coins are eligible — no Krugerrands, other foreign pieces or previously issued U.S. coins. The government began issuing American Eagle coins today. The series: gold coins in denominations of $50 (1 ounce), $25 (half ounce), $10 (quarter ounce) and $5 (one-tenth ounce), and a $1, 1-ounce silver coin. Denominations are just descriptive; they'll be priced at a premium over the spot market price. Gold was $419.30 an ounce Friday.

■ If you invest in coins for your IRA, you can't keep them You'll have to name a bank or other institution as custodian and pay a storage fee. "They're difficult to store, and if they get nicked or chipped they lose value," says Dodge Dutcher, senior vice president and director of trust services at Shearson Lehman Bros. Inc.

■ Unlike mutual funds, stocks and other IRA assets, coins don't pay interest or dividends. So coins add nothing to your IRA unless you sell them at a profit.

You can sell your IRA gold coins and avoid taxes on the profit as long as you reinvest the proceeds in other IRA assets.