What's New for 2004

This section summarizes important tax changes that took effect in 2004. Most of these changes are discussed in more detail throughout this publication.

Changes are also discussed in Publication 553, Highlights of 2004 Tax Changes.

Higher taxable income limits for using Form 1040A, 1040EZ, and TeleFile. Beginning with the 2004 return, the income limit for using Form 1040A, Form 1040EZ, and TeleFile will increase to taxable income of less than $100,000. Previously, the limit was taxable income of less than $50,000. See chapter 1 for other requirements to use these forms.

Tax Computation Worksheet. If your taxable income for 2004 is $100,000 or more, you will figure your 2004 tax using a new Tax Computation Worksheet, rather than the Tax Rate Schedules. The Tax Computation Worksheet is found on page 285. The Tax Rate Schedules are shown on page 284 so you can see the tax rate that applies to all levels of taxable income. Do not use them to figure your tax.

Standard mileage rates. The standard mileage rate for the cost of operating your car increased to 37.5 cents a mile for all business miles driven. See chapter 28.

The standard mileage rate allowed for use of your car for medical reasons increased to 14 cents a mile. See chapter 23.

The standard mileage rate allowed for use of your car for determining moving expenses increased to 14 cents a mile. See chapter 19.

Retirement savings plans. The following paragraphs highlight changes that affect individual retirement arrangements (IRAs) and pension plans.

Traditional IRA income limits. If you have a traditional IRA and are covered by a retirement plan at work, the amount of income you can have and not be affected by the deduction phaseout increases. The amounts vary depending on filing status. See chapter 18.

Limit on elective deferrals. The maximum amount of elective deferrals under a salary reduction agreement that could be contributed to a qualified plan increased to $13,000 ($16,000 if you were age 50 or over). However, for SIMPLE plans, the amount increased to $9,000 ($10,500 if you were age 50 or over).

Health savings accounts (HSAs). You may be able to deduct contributions made to your health savings account (HSA). HSAs are discussed in Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans.

Deduction for clean-fuel vehicle. You can claim the maximum amount allowed for a clean-fuel vehicle or other clean-fuel vehicle property you placed in service in 2004. The 25% reduction of the maximum amount for 2004 has been eliminated. See Publication 535, chapter 12, for more information on the deduction.

Tax credit for qualified electric vehicle. You can claim the maximum tax credit allowed for a qualified electric vehicle you placed in service in 2004. The 25% reduction of the maximum credit for 2004 has been eliminated. See chapter 39 for more information.

Educator expenses. The deduction as an adjustment to gross income for educator expenses was scheduled to expire at the end of 2003. However, the provision has been extended until the end of 2005. The expenses can be deducted on Form 1040, line 23, or Form 1040A, line 16.

Additional child tax credit. In determining the additional child tax credit, the percentage of taxable earned income taken into account is increased to 15%. Also, taxable earned income, for this purpose, includes combat pay.

Earned income credit. You can now choose to include combat pay in your earned income for purposes of computing this credit.

Sales tax deduction. You can elect to deduct state and local general sales taxes instead of state and local income taxes as an itemized deduction on Form 1040, Schedule A. See chapter 24 for more information.

Income averaging for farmers and fishermen. Fishermen can elect to use income averaging on Form 1040, Schedule J, Income Averaging for Farmers and Fishermen, to reduce their tax. Also, the benefit of income averaging is extended to farmers and fishermen who owe the alternative minimum tax. See the Instructions for Form 1040, Schedule J for details.

Student loan interest deduction The person legally obligated to make interest payments on a student loan may be able to deduct interest payments on that loan made by someone else. See chapter 21 for more information.

Tuition and fees deduction increased. The amount of qualified education expenses you can take into account in figuring your tuition and fees deduction increased. See chapter 21 for more information.

Hope or lifetime learning credit income limits increased. The amount of income you can have and still receive a Hope or lifetime learning credit has increased. See chapter 21 for more information.

Qualified tuition program (QTP) distributions. You may be able to exclude from income distributions from a QTP established and maintained by an eligible educational institution if the distributions are not more than your qualified higher education expenses. See chapter 13 for more information.

Certain amounts increased. Some tax items that are indexed for inflation increased for 2004.

Earned income credit (EIC). The maximum amount of income you can earn and still get the earned income credit increased. The amount depends on your filing status and number of children. The maximum amount of investment income you can have and still be eligible for the credit has increased to $2,650. See chapter 38.

Standard deduction. The standard deduction for taxpayers who do not itemize deductions on Schedule A (Form 1040) has increased. The amount depends on your filing status. See chapter 22.

Exemption amount. You are allowed a $3,100 deduction for each exemption to which you are entitled. However, your exemption amount could be phased out if you have high income. See chapter 3.

Limit on itemized deduction. Some of your itemized deductions may be limited if your adjusted gross income is more than $142,700 ($71,350 if you are married filing separately). See chapter 31.

Tax benefits for adoption. The adoption credit and the maximum exclusion from income of benefits under an employer's adoption assistance program are increased to $10,390. See *Adoption Credit* in chapter 39 and Publication 968, Tax Benefits for Adoption.

Social security and Medicare taxes. The maximum wages subject to social security tax (6.2%) increased to $87,900. All wages are subject to Medicare tax (1.45%).

What's New for 2005

This section summarizes the important changes that take effect in 2005 that could affect your estimated tax payments for 2005. More information on these and other changes can be found in Publication 553.

Retirement savings plans. The following paragraphs highlight changes that affect individual retirement arrangements (IRAs) and pension plans.

Traditional IRA income limits. If you have a traditional IRA and are covered by a retirement plan at work, the amount of income you can have and not be affected by the deduction phaseout increases. The amounts vary depending on filing status.

Limit on elective deferrals. The maximum amount of elective deferrals under a salary reduction agreement that can be contributed to a qualified plan increases to $14,000 ($18,000 if you are age 50 or over). However, for SIMPLE plans, the amount increases to $10,000 ($12,000 if you are age 50 or over).

IRA deduction expanded. The amount you, and your spouse if filing jointly, may be able to deduct as an IRA contribution will increase to $4,000 ($4,500 if age 50 or older at the end of 2005). See chapter 18 for more information.

Deduction for clean-fuel vehicle. You can claim the maximum amount allowed for a clean-fuel vehicle or other clean-fuel vehicle property you place in service in 2005. The 50% reduction of the maximum amount for 2005 has been eliminated. See Publication 535, chapter 12, for more information on the deduction.

Tax credit for qualified electric vehicle. You can claim the maximum tax credit allowed for a qualified electric vehicle you place in service in 2005. The 50% reduction of the maximum credit for 2005 has been eliminated. See chapter 39 for more information.

Uniform definition of a child. Beginning in 2005, the definition of "qualified child" for the following tax benefits will change.

- Dependency exemption.
- Head of household filing status.
- Earned income credit (EIC).
- Child tax credit.
- Child and dependent care credit.

Reminders

Listed below are important reminders and other items that may help you file your 2004 tax return. Many of these items are explained in more detail later in this publication.

Write in your social security number. To protect your privacy, social security numbers (SSNs) are not printed on the peel-off label that comes in the mail with your tax instruction booklet. This means you must enter your SSN in the space provided on your tax form. If you filed a joint return for 2003 and are filing a joint return for 2004 with the same spouse, enter your names and SSNs in the same order as on your 2003 return. See chapter 1.

Taxpayer identification numbers. You must provide the taxpayer identification number for each person for whom you claim certain tax benefits. This applies even if the person was born in 2004. Generally, this number is the person's social security number (SSN). See chapter 1.

Reporting interest and dividends. If you have interest or dividend income of more than $1,500, you have to file Schedule 1 (Form 1040A) or Schedule B (Form 1040) with your tax return. Also, you cannot file Form 1040EZ if you have more than $1,500 of taxable interest income.

Tax relief for victims of terrorist attacks. Under the Victims of Terrorism Tax Relief Act of 2001, the federal income tax liability of those killed in the following attacks is forgiven for certain tax years.

- The April 19, 1995, terrorist attack on the Alfred P. Murrah Federal Building (Oklahoma City).
- The September 11, 2001, terrorist attacks.
- The terrorist attacks involving anthrax occurring after September 10, 2001, and before January 2, 2002.

The Act also exempts from federal income tax certain amounts received by survivors.

For more information, see Publication 3920, Tax Relief for Victims of Terrorist Attacks.

Benefits for public safety officer's survivors. A survivor annuity received by the spouse, former spouse, or child of a public safety officer killed in the line of duty will generally be excluded from the recipient's income regardless of the date of the officer's death. The provision applies to a chaplain killed in the line of duty after September 10, 2001. The chaplain must have been responding to a fire, rescue, or emergency as a member or employee of a fire or police department. See chapter 13.

Parent of a kidnapped child. The parent of a child who is presumed by law enforcement authorities to have been kidnapped by someone who is not a family member may be able to take the child into account in determining his or her eligibility for the following.

- Head of household or qualifying widow(er) with dependent child filing status.
- Exemption for dependents.
- Child tax credit.
- Earned income credit.

See Publication 501, Exemptions, Standard Deduction, and Filing Information and Publication 596, Earned Income Credit (EIC).

Payments received by Holocaust victims. Restitution payments received after 1999 (and certain interest earned on the payments) are not taxable and do not affect the taxability of certain benefits, such as social security benefits. For more details, see chapter 13.

Advance earned income credit. If a qualifying child lives with you and you expect to qualify for the earned income credit in 2005, you may be able to get part of the credit paid to you in advance throughout the year (by your employer) instead of waiting until you file your tax return. See chapter 38.

Sale of your home. Generally, you will only need to report the sale of your home if your gain is more than $250,000 ($500,000 if married filing a joint return). See chapter 16.

Retirement planning services. If your employer has a qualified retirement plan, qualified retirement planning services provided for you (or your spouse) by your employer are not included in your income. For more information, see *Retirement Planning Services* under *Fringe Benefits* in chapter 6.

Individual retirement arrangements (IRAs). The following paragraphs highlight important reminders that relate to IRAs. See chapter 18 for details.

IRA for spouse. A married couple filing a joint return can contribute up to the maximum amount each to their IRAs, even if one spouse had little or no income.

Spouse covered by plan. Even if your spouse is covered by an employer-sponsored retirement plan, you may be able to deduct contributions to your traditional IRA if you are not covered by an employer plan.

Roth IRA. You may be able to establish a Roth IRA. In this type of IRA, contributions are not deductible but earnings grow tax free and qualified withdrawals are not taxable. You may also be able to convert a traditional IRA to a Roth IRA, but you must include all or part of the taxable converted amount in income.

Retirement savings contributions credit. If you contribute to an individual retirement arrangement (IRA) or to a retirement plan sponsored by your employer, you may qualify for a tax credit. See *Retirement Savings Contributions Credit* in chapter 39.

Foreign source income. If you are a U.S. citizen with income from sources outside the United States (foreign income), you must report all such income on your tax return unless it is exempt by U.S. law. This is true whether you reside inside or outside the United States and whether or not you receive a Form W-2 or 1099 from the foreign payer. This applies to earned income (such as wages and tips) as well as unearned income (such as interest, dividends, capital gains, pensions, rents and royalties).

If you reside outside the United States, you may be able to exclude part or all of your foreign source earned income. For details, see Publication 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad.

Child tax credit. You may be able to claim a tax credit for each of your qualifying children under age 17 at the end of the year. See chapter 36.

Health insurance credit. If you are an eligible individual, you can claim a tax credit equal to 65% of the amount you pay for qualified health insurance coverage. See chapter 39.

Joint return responsibility. Generally, both spouses are responsible for the tax and any interest or penalties on a joint tax return. In some cases, one spouse may be relieved of that responsibility for items of the other spouse that were incorrectly reported on the joint return. For details, see *Joint responsibility* in chapter 2.

Include your phone number on your return. To promptly resolve any questions we have in processing your tax return, we would like to be able to call you. Please enter your daytime telephone number on