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TAX CHANGES FOR TAX YEAR 2001

The sheer volume of tax changes and their complexity make it difficult to keep track of what's new and what's been changed. The tax laws enacted in the last couple of years contain important provisions effective for the first time in 2001. In addition, key established tax breaks are liberalized beginning in 2001. To inform you of what's new in the tax rules, here's a summary of the major tax changes for 2001, broken down into four categories: Personal Income Taxes, Retirement Plan Changes, Tax Changes for Business, and Estate and Gift Tax Changes. If you'd like to discuss how these changes affect your personal and business situation, please give me a call.

PERSONAL INCOME TAXES

Lower taxes on 5-year capital gains. Persons who are in the 15% tax bracket will pay a tax of only 8% (rather than 10%) on capital gains from assets such as stock that they have held for at least five years before sale. If you're in a higher tax bracket, the rules are different. Gain from the sale or exchange of capital assets held more than 5 years will be taxed at 18% (as opposed to 20%), but only if they were bought after 2000. As a result, those in higher brackets won't benefit from a lower capital-gains rate before 2006.

Those in the 28% bracket or higher can make a special election for a capital asset they owned at the beginning of 2001. If the election is made for stock, it is treated as having been sold on January 2, 2001, for its closing market price on that date, and reacquired on that date for that closing market price (the deemed sale date is January 1, 2001, for eligible capital assets that aren't readily tradable stocks). Any gain is recognized (included in income), but a loss on the deemed sale is disallowed. This election assures that any gain five years down the road won't be taxed higher than 18% while avoiding sales and purchase commissions. Once made, the deemed-sale-and-repurchase election is irrevocable.

Boosted deduction for education loan interest. You can deduct up to $2,500 of interest paid on an education loan ($2,000 in 2000), but the deduction phases out over $40,000 to $55,000 of adjusted gross income as specially modified (between $60,000 and $75,000 on joint returns).

Higher estimated tax payments for some. Your estimated tax burden for 2001 may increase slightly if your adjusted gross income for 2000 was over $150,000 ($75,000 for marrieds filing separately). If you fall in this category, you will escape an estimated tax underpayment penalty for 2001 if your estimated tax payments for 2001 are at least equal to (1) 110% of the tax shown on your return for 2000, or (2) 90% of the tax for 2001, whichever is less. For 2000, if your adjusted gross income for 1999 was over $150,000 ($75,000 for marrieds filing separately) you escape an estimated tax underpayment penalty for 2000 if your estimated tax payments for 2000 were at least equal to (1) 108.6% of the tax shown on your return for '99, or (2) 90% of the tax for 2000, whichever is less.

Higher threshold for nanny tax reporting. Pay for a domestic's services in your home isn't subject to social security tax (FICA) if the amount you pay the domestic during the year is below $1,300 ($1,200 for 2000).

RETIREMENT PLAN CHANGES

Required minimum distribution rules overhauled. You must begin taking minimum annual distributions from your traditional IRAs, 401(k)s, and other individual accounts in an employer-sponsored defined contribution plan (such as a profit-sharing plan) when you attain a certain age. For most people, the required beginning date for payouts is April 1st following the year in which they turn age 70 1/2. The IRS has just simplified and liberalized the rules that determine the minimum annual distribution that must be withdrawn from these types of retirement accounts. In general, you'll have to withdraw less each year under the revised rules than you did under pre-existing IRS guidance. For those looking to withdraw the rock-bottom minimum from their retirement plan accounts, the new rules will result in a lower tax bill, a longer-lived tax shelter for the family and potentially larger payouts for the owner's beneficiaries. The IRS has made many other changes in the required minimum distribution rules. For example, you no longer have to name a designated beneficiary when you begin taking required payouts from your retirement accounts.

Key pension figures are changed. Several figures important for purposes of calculating pension- and profit-sharing plan benefits have gone up for 2001. For example:

… the dollar limit on the annual benefit that can be funded in a defined benefit (i.e., pension-type) plan is $140,000 ($135,000 in 2000);
… the annual additions to a defined contribution plan account increase to the lesser of 25% of compensation or $35,000 (up from $30,000 for 2000); and
… the maximum amount of compensation an employee may elect to defer under a SIMPLE plan increases to $6,500, up from $6,000 for 2000.

More people can make deductible IRA contributions. The up-to-$2,000 deduction for contributions to traditional IRAs made by active participants in an employer-sponsored plan begins to phase out when AGI exceeds $53,000 (joint return filers) or $33,000 (single or head of household). For 2000, the deduction phaseout begins at $52,000 and $32,000 of AGI respectively.

TAX CHANGES FOR BUSINESS

Higher expensing limit. The maximum amount of equipment purchases that can be expensed (currently deducted instead of being depreciated over a period of years) is $24,000 ($20,000 for 2000).

Higher business mileage rate. The simplified deduction for business auto use during 2001 is 34.5¢ per business mile traveled (up from 32.5¢ for 2000).

You may have to file via electronic deposit. Your business must use the Electronic Federal Tax Payment System (EFTPS) for all depository taxes (e.g., employment, excise tax, corporate income tax) if the total of such taxes in 1999 was more than $200,000, or it was required to use EFTPS in 2000.

Electronic returns for large partnerships. Partnerships with more than 100 partners must file their returns electronically, effective for tax years ending on or after December 31, 2000.

More small businesses can pay employment taxes quarterly. Effective January 1, 2001, businesses may make employment tax payments quarterly (rather than monthly or more frequently) if they have less than $2,500 in quarterly employment taxes (the threshold had been $1,000).

ESTATE AND GIFT TAX CHANGES

The following favorable changes kick in this year:

... An executor may elect to exclude from the gross estate up to 40% of the value of land subject to a qualified conservation easement meeting certain requirements and subject to a dollar cap. This dollar cap is $400,000 for 2001 ($300,000 for 2000).

... If certain conditions are met, an executor may elect to value qualified real property used for farming purposes or in a trade or business on the basis of the property's value for its actual use, rather than on its highest and best use. The total decrease in the value of all real property under this election may not exceed $800,000 for 2001 ($770,000 for 2000).

Comments is an informative publication for our clients and friends of the Firm. It is designed to provide accurate information on the subject matter covered. We recommend you consult with your legal and other advisors to determine if the information is applicable in your specific circumstances. If these advisors are not available to you, please feel free to contact Barry N. Finkelstein, CPA at 972/934-1577 or e-mail at info@facpa.com.