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KEY CHANGES IN THE ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001

After months of Congressional debate, the tax relief package entitled the Economic Growth and Tax Relief Reconciliation Act of 2001 has become law. The Act's centerpieces are marginal income tax rate cuts, marriage-penalty relief, phase-down and eventual repeal of the estate tax and a doubling of the child tax credit. The Act also increases incentives for retirement and education savings and makes some temporary adjustments to the alternative minimum tax. Here's a summary of the major tax changes contained in the Act. Please call me if you would like to discuss how these changes affect your personal and business situation.

TAX RATE REDUCTIONS

The Act cuts individual income taxes across the board, but the cuts are phased in gradually through 2006. A new 10% bracket applies to the first $6,000 of taxable income for singles, $10,000 for heads of household and $12,000 for married joint filers. For 2001, most individuals will get the benefit of this new bracket in the form of tax rebate checks beginning in July. In addition, tax rates higher than 15% will be phased down. For 2001, the old rates of 28%, 31%, 36% and 39.6% each drop a half of a percentage point; by 2006, they will have dropped in stages to 25%, 28%, 33%, and 35%, respectively.

The overall limit on itemized deductions (which causes loss of up to 80% of certain itemized deductions) and the phaseout of personal exemptions for higher income taxpayers will be gradually repealed starting in 2006, in effect lowering marginal tax rates for affected taxpayers.

The AMT exemption amount for married couples filing a joint return has been increased by $4,000 ($2,000 for singles and separately filing marrieds) for 2001 through 2004. After 2004, the AMT exemption amounts will return to the levels in effect for 2000 unless Congress does something to change it.

MARRIAGE-PENALTY RELIEF

Marriage penalty relief will not start to take effect until 2005. Relief will come in the form of increases in the standard deduction for joint filers, as well as an expansion of the 15% bracket for married couples to twice the amount of the 15% bracket for singles.

ESTATE TAX REPEAL

From 2002 through 2009, estate and gift tax rates will be reduced, with the top rate gradually falling from the current 55% rate to 45%. In addition, the current $675,000 amount that is exempt from estate taxes will rise to $1 million in 2002, $1.5 million in

2004, $2 million in 2006, and $3.5 million in 2009 (the lifetime gift exclusion remains at $1 million).

The estate tax and the related generation-skipping transfer (GST) tax will be fully repealed in 2010. The gift tax will not be repealed, however, and gifts above the $1 million exemption will be subject to a 35% maximum rate.

As noted above, the estate and generation-skipping transfer taxes will be repealed after 2010. After repeal, the basis of assets received from a decedent generally will carry over from the decedent, rather than being stepped-up to date-of-death value as under current law. Heirs will instead have to determine the cost of each asset in the estate at the time it was acquired by the person who died, perhaps decades earlier. However, a decedent's estate will be able to increase the basis of assets transferred by up to $1.3 million, and, for assets transferred to a surviving spouse, by an additional $3 million. The executor will be able to elect the assets that will receive the basis increase.

 # EDUCATION INCENTIVES

A wide array of changes are designed to assist taxpayers meet education costs. These include:

1. Education IRAs expanded:
   Starting in 2002, the annual contribution limit to education IRAs is increased from $500 to $2,000 and these accounts are expanded to cover costs associated with primary and secondary school and other school-related expenses.
2. Qualified tuition programs expanded:
   Tax-free distributions from State plans will be allowed, starting in 2002. Private institutions will be allowed to offer prepaid tuition plans, tax-deferred in 2002, with tax-free distributions beginning in 2004.
3. Employer-provided educational assistance:
   The exclusion for up to $5,250 a year of employer-provided benefits is made permanent and extended to graduate courses beginning after 2001.
4. Student loan interest deduction:
   After 2001, the phaseout ranges for eligibility for the deduction are increased and the 60-month limit on interest deductibility is repealed.
5. Deduction for higher education expenses:
   Taxpayers (even those who don't itemize) within certain income ranges can deduct college tuition expenses, up to $3,000 in 2002 and 2003, and up to $4,000 in 2004 and 2005.
6. National Health and Armed Forces scholarships:
   Amounts awarded after 2001 are tax-free, without regard to any service obligation by the recipient, but not for amounts received by students for regular living expenses, including room and board.

 # IRA AND PENSION PROVISIONS

There are a wide variety of changes designed to encourage retirement savings. These include:

1. IRA contribution limits:
   The annual contribution limit for IRA contributions increases to $3,000 for 2002 to 2004, $4,000 for 2005 to 2007, and $5,000 for 2008 and later years.
2. Catch-up contributions:
   Individuals age 50 or older can make additional catch-up IRA contributions of $500 for 2002 to 2005 and $1,000 for 2006 and later years.
3. Qualified plan limits:
   There are many favorable changes, including generous increases in many of the contribution and benefit limits.
4. Larger elective deferrals:
   The maximum annual elective deferral to 401(k) plans, 403(b) annuities and salary reduction SEPs will rise from the current $10,500 to $11,000 in 2002, and then in $1,000 annual increments until it reaches $15,000 in 2006. The maximum contribution to a SIMPLE plan will rise from $6,500 to $7,000 in 2002 and thereafter at a rate of $1,000 a year until it reaches $10,000 in 2005.
5. Additional "catch-up" contributions:
   The dollar limits on elective deferrals are increased further for individuals who are 50 or older; the additional amount is $1,000 for 2002, $2,000 for 2003, $3,000 for 2004, $4,000 for 2005, and $5,000 for 2006 and later years. Different catch-up contribution amounts will be allowed to those in SIMPLE plans.
6. Credit for low- and middle-income savers:
   The Act creates a nonrefundable credit for low- and middle-income savers of up to 50% of contributions to employer plans or IRAs, in addition to any deduction or exclusion that would apply.

 # CHILD TAX CREDIT

The current $500 maximum credit per child increases to $600 for 2001 and then gradually climbs to $1,000 for 2010. In addition, the credit now will be refundable for many low-income taxpayers and is permanently allowed against the AMT.

 # DEPENDENT CARE CREDIT

Starting in 2003, more child-care expenses will qualify for the dependent care credit and the maximum credit rate will increase from 30% to 35%. The maximum credit will increase to $1,050 for one child and to $2,100 for two or more. The phase-down of the credit will also be modified: The maximum 35% credit rate will be reduced, but not below 20%, by 1 percentage point for each $2,000 (or fraction thereof) of AGI above $15,000. As a result, more individuals will qualify for more than the minimum credit.