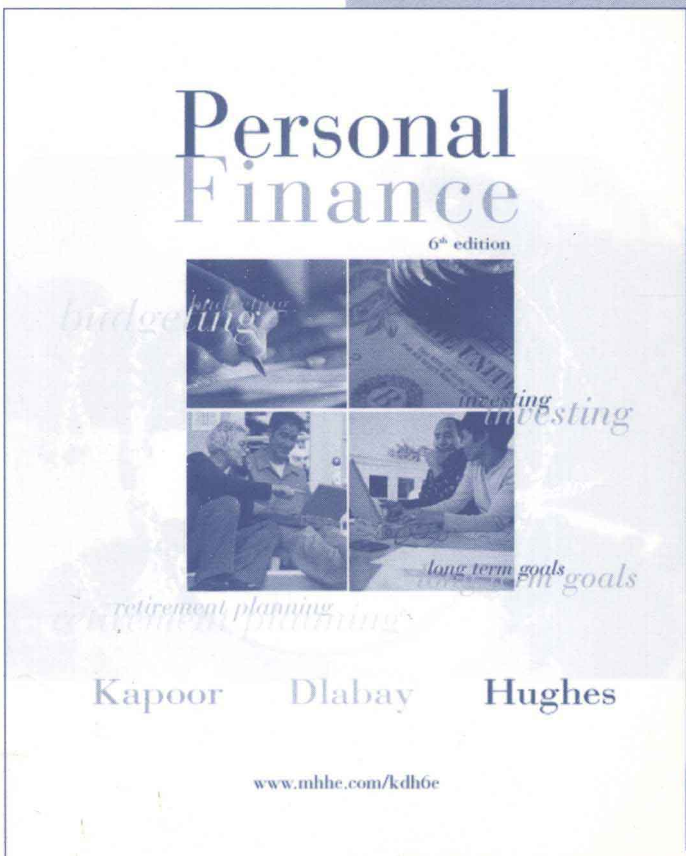
A Summary of The Economic and Tax Relief Reconciliation Act of 2001

to accompany



A Summary of The Economic and Tax Relief Reconciliation Act of 2001

to accompany

Personal Finance

Sixth Edition

Jack R. Kapoor
College of DuPage

Les R. Dlabay
Lake Forest College

Robert J. Hughes
Dallas County Community College

McGraw-Hill Irwin

Boston Burr Ridge, IL Dubuque, IA Madison, WI New York San Francisco St. Louis
Bangkok Bogotá Caracas Kuala Lumpur Lisbon London Madrid Mexico City
Milan Montreal New Delhi Santiago Seoul Singapore Sydney Taipei Toronto

McGraw-Hill Higher Education
A Division of The McGraw-Hill Companies

A Summary of The Economic and Tax Relief Reconciliation Act of 2001 to accompany
PERSONAL FINANCE
Jack R. Kapoor, Les R. Dlabay, Robert J. Hughes

Published by McGraw-Hill/Irwin, an imprint of The McGraw-Hill Companies, Inc., 1221 Avenue of the Americas, New York, NY 10020.

2 3 4 5 6 7 8 9 0 2DOC/2DOC 0 9 8 7 6 5 4 3 2

ISBN 0-07-283614-8

www.mhhe.com

The Economic Growth and Tax Relief Reconciliation Act was passed by Congress in late May 2001. The Act is the largest tax cut in two decades and is estimated to cut federal taxes by $1.35 trillion through 2011. The Act reduces marginal income tax rates, repeals the estate tax and generation-skipping transfer taxes, provides marriage penalty relief, and increases contributions to retirement accounts. However, many of the provision of the Act are scheduled to expire on December 31, 2010.

Highlights of the tax law changes include:

- Tax rates decline from a maximum of 39.6 percent to 35 percent; lowest rate declines to 10 percent from 15 percent.
- Retirement plans: Increased amounts and expanded participation for individual retirement accounts, 401(k) plans, and other pension plans.
- Marriage status deduction and tax rates: No change until 2005 when standard deduction for married couples gradually increases until it is twice the single level in 2009, and the 15 percent tax bracket gradually enlarged to apply to more of a married couple's income instead of the next higher rate.
- Child tax credit $600 per child (a $100 increase from 2001), with additional increases to $1,000 by 2010.
- Education credit programs: new deductions starting in 2002 for education expenses.
- Estate taxes: the exemption gradually increases from $675,000 to $3.5 million in 2009. However, in 2011, unless Congress takes further action, taxable amounts and rates for estate taxes will revert to 2001 levels.

Additional tax information available from:

Internal Revenue Service at www.irs.gov
Quicken at www.quicken.com/taxes
Money Magazine and CNN at www.money.com/taxes
Tax Planet at www.taxplanet.com
H&R Block at www.hrblock.com

Chapter 4—Planning Your Tax Strategy

Topic (text pages)	2002 Tax Changes
Standard deduction (p. 101)	No change until 2005 when standard deduction for married couples gradually increases until it is twice the single level in 2009.
Tax rates (p. 103)	• Tax rates decline from a maximum of 39.6 percent to 35 percent; lowest rate declines to 10 percent from 15 percent. • Married couples tax rates: No change until 2005 when the 15 percent tax bracket gradually enlarges to apply to more of a married couple's income instead of the next higher rate.
Tax credit (p. 104)	Child tax credit $600 per child (a $100 increase from 2001), with additional increases to $1,000 by 2010.
Capital gains (pp. 122-123)	Rates gradually reduced through 2006 (see table below for Chapter 13).
Traditional IRA (p. 122)	Gradually raises the maximum amount that can be contributed to an IRA (both traditional and Roth) from $2,000 to $5,000 in 2008. After that, the maximum contrubuted will be adjusted for inflation.
Roth IRA (p. 122)	Creates a Roth 401(k), which takes effect in 2006, allowing got after-tax contributions that grow tax-free.

Topic (text pages)	2002 Tax Changes
Education IRA (pp. 122-123)	Renamed "Education Savings Accounts," contribution limit to increase from $500 to $2,000; extended to elementary and secondary-school expenses; income-eligibility limits raised for married couples.
Other Education Savings Options	• Student Loan Deduction: income-eligibility limits raised and 60-month limit on deductibility eliminated in 2002. • New College Tax Education: deduction of up to $3,000 (rising to a maximum of $4,000) that can be claimed. • State-Sponsored College Savings Plan: tax-free treatment starting in 2002 for state-sponsored college savings accounts and prepaid tuition plans.
401(k) Plan (p. 123)	Contribution limits gradually increased from $10,500 to $15,000; higher limits for workers age 50 and over.

Chapter 13—Investing Fundamentals

Topic (text pages)	2002 Tax Changes
Capital Gains and Capital Losses (p. 429)	The example assumes that Joe Coit is in the 28 percent tax bracket. The Economic Growth and Tax Relief Reconciliation Act of 2001 lowers the tax rates as noted here:

Calendar Year	28 percent bracket	31 percent bracket	36 percent bracket	39.6 percent bracket
2002-2003	27%	30%	35%	38.6%
2004-2005	26%	29%	34%	37.6%
2006-2010	25%	28%	33%	35%

Chapter 15—Investing in Bonds

Topic (text pages)	2002 Changes
Treasury Bills, Notes, and Bonds (p. 493)	Treasury Bills and Treasury Notes are now purchased through Treasury Direct with offices in Boston, Minneapolis, and Dallas. Treasury Bills and Treasury Notes are no longer sold through Federal Reserve Banks or their branches.

Topic (text pages)	2002 Changes
Treasury Bills (p. 494)	Currently, the maturities for Treasury Bills are either 13 weeks or 26 weeks. There is no longer a Treasury Bill with a 52-week maturity.
Treasury Bonds (p. 494)	The federal government no longer sells treasury bonds. They are still available, but only in the secondary market where they can be bought from an investor who owns them.
Tax-equivalent yield example (p. 497)	Instructors may want to use the new, lower tax rates described in Chapter 13 to illustrate this concept.
Chapter Summary Objective 4 (p. 506)	Treasury Bills and Treasury Notes are now purchased through Treasury Direct with office in Boston, Minneapolis, and Dallas. Treasury Bills and Treasury Notes are no longer sold through Federal Reserve Banks or their branches.

Chapter 18—Retirement Planning

The Economic Growth and Tax Relief Reconciliation Act (the Act) was passed by Congress in late May 2001. The Act is the largest tax cut in two decades and is estimated to cut federal taxes by $1.35 trillion through 2011. The Act reduces marginal income tax rates, repeals the estate tax (pp. 627 – 628) and generation – skipping transfer taxes (p. 624), provides marriage penalty relief, and increases contributions to retirement accounts. However, as enacted, the entire Act will expire after December 31, 2010. The new law introduces significant changes that affect retirement and estate planning.

Topic (text pages)	2002 Tax Changes
Defined-Contribution Plan (p. 586)	The new law increased the contribution limit to the lesser of $40,000 or 100 percent of compensation beginning in 2002. The old limit was the lesser of $35,000 or 25 percent of income.
Employer Pension Plans (p. 586)	• Most employer plans are defined-contribution or defined-benefit plans. • The new law also increased the employee contribution limit for 401(k) and other employer –sponsored retirement plans. For example, you can contribute $11,000 to your 401(k), 403(b) and Section 457 plans in 2002. As shown in the following table, the annual limit increases to $15,000 by 2006.

Plan Year	Annual Limit for 401(k), 403(b) and Section 457 plans (for those under age 50)
2002	$11,000
2003	$12,000
2004	$13,000
2005	$14,000
2006 and after*	$15,000

(*Indexed for inflation after 2006 in $500 increments)

Furthermore, if you are 50 or older, you can contribute more than the above limits. This new provision is intended to allow older workers to make up for the lost time and catch up on their contributions. For example, in the 401(k) and 403(b) plans the older workers can contribute from $12,000 to $20,000 annually for the plan years 2002 to 2006.

Plan Year	Contribution Limit (Age 50 and Older)
2002	$12,000
2003	14,000
2004	16,000
2005	18,000
2006 and after*	20,000

(Indexed for inflation after 2006 in $500 increments)

Defined-Benefit Plan (p. 587)	The maximum annual dollar limit on payments you can receive from a defined-benefit plan is increased from $140,000 in 2001 to $160,000. This limit is indexed for inflation in $5,000 increments.
Personal Retirement Plans (p. 588)	The two most popular personal retirement plans are individual retirement accounts (IRAs) and Keogh accounts: • Individual Retirement Accounts (IRAs): The new law increased the amount of money you can contribute each year to IRAs. As shown in the following table, the annual contribution limit gradually increases for both traditional and Roth IRAs from $2,000 in 2001 to $5,000 in 2008. • As with 401(k) and 403(b) plans, if you are 50 or older, you can contribute $500 more than the regular limits starting in 2002. As shown in the table below, the amount increases to $1,000 beginning in 2005. • To encourage lower-income workers, the new law provides a temporary credit for contributions to IRAs, 401(k) and other employer-sponsored retirement plans. This credit,

	depending on your income, ranges from 10 to 50 percent of the contribution, and is available from 2002 to 2006. The maximum annual contribution eligible for the credit is $2,000. The credit is available only if you Adjusted Gross Income (AGI) is $50,000 or less on a joint return, $37,500 for heads of households and $25,000 for singles.

Year	IRA Contribution Limit
2001	$2,000
2002-2004	$3,000
2005-2007	$4,000
2008 and after*	$5,000

(*Indexed for inflation after 2008 in $500 increments)

Year	Contribution Limits for 50 and Older
2001	$2,000
2002-2004	$3,500
2005	$4,500
2006-2007	$5,000
2008 and thereafter*	$6,000

(*Adjusted for inflation after 2008 rising in $500 increments)

This table below summarizes the new law's most important provisions for regular IRAs, Roth IRAs, 401(k), 403(b), and 457 plans.

		IRA/ROTH IRA		401(k), 403(b), 457	
You will be allowed to set aside more in retirement accounts, raising contribution limits starting this year. Turn 50 by year-end and you get an added boost from special catch-up provisions.		UNDER 50 YEARS OLD	50 AND ABOVE	UNDER 50	50 AND ABOVE
	2001	$2,000	$2,000	$10,500*	$10,500*
	2002	3,000	3,500	11,000	12,000
	2003	3,000	3,500	12,000	14,000
	2004	3,000	3,500	13,000	16,000
	2005	4,000	4,500	14,000	18,000
	2007	4,000	5,000	**	**
	2008	5,000	6,000	**	**

*$8,500 for 457 **Indexed for inflation, rising in $500 increments.
(Source: *BusinessWeek*, January 28, 2002, p. 111.)

Rollover IRA (p. 591)	The new law makes retirement savings more portable, permitting workers to roll money between 401(k)s, 403(b)s, and governmental 457s. That's especially good now for those with a 457. Before, you could not even transfer savings into an IRA when you left a job. You can now also roll regular deductible IRA savings into a 401(k). Beginning in 2003, employers can help workers set up IRAs at the workplace. Better yet, in 2006 employers may be able to offer Roth-style

	401(k)s or 403(b)s. You can then split contributions between a regular 401(k) and one similar to a Roth.
Education IRA (p. 591)	The Education IRA, renamed *the Coverdell Education Savings Account* after the late Senator Paul Coverdell, has also been enhanced. You can now give \$2,000 a year to each child—up from \$500—for the Education IRA. These accounts grow tax-free and can be invested any way you choose. Coverdells can now be used for elementary and secondary school costs, including books, tuition, and tutoring. And more families can set up Coverdells, thanks to higher income limits. A married couple can contribute the full \$2,000 if its AGI is \$190,000 or less, up from \$160,000 in 2001.
Simplified Employee Pension Plans – IRA (SEP-IRA) (p. 593)	The new tax package did not forget the self-employed. If you have a SEP or a profit-sharing Keogh plan, you can contribute up to \$40,000. A glitch in another part of the law limits deduction to 15 percent of first \$200,000 in self-employment, or \$30,000, but Congress is expected to correct that. (*BusinessWeek*, January 28, 2002, p. 111).
Keogh Plans (p. 594)	All self-employed individuals can establish Keogh plans. The maximum annual tax deduction in 2001 was the lesser of \$35,000 (\$40,000 in 2002) or 15 percent of net self-employment income not in excess of \$170,000 (\$200,000 in 2002). As stated earlier, if you have a defined-benefit Keogh, the annual payout rises from \$140,000 to \$160,000.

ıpter 19—Estate Planning

The Economic Growth and Tax Relief Reconciliation Act of 2001 brought important changes to the federal estate, gift, generation-skipping transfer taxes (GST), including a potential one-year repeal of the estate and GST taxes after 2009. However, the elimination of these taxes will be brief unless Congress considers legislation to permanently remove estate and GST taxes. As the Act stands now, all of its provisions will be repealed as of December 31, 2010. Consequently, the estate, gift, and GST tax provisions in effect in 2001 will become the law once again on January 1, 2011—unless Congress takes intervening action.

Topic (text pages)	2002 Tax Changes
Estate planning (pp. 620-631)	• Many changes in the estate, gift, and generation-skipping transfer taxes will be phased in gradually during this decade. For example, the amount exempt from estate tax will rise to $1.09 million in 2002. The amount exempt from GST tax, which was $1.06 million in 2001, will be adjusted for inflation in 2002 and 2003. Both exemptions (estate tax and GST tax) will increase to $1.5 million in 2004, to $2.0 million in 2006, and to $3.5 million in 2009. • Even though estate and GST taxes are repealed in 2010, note that the gift tax is not scheduled to be repealed. The Table below summarizes the important provisions pertaining to estate planning.

ESTATE TAX LAW CHANGES

Tax Year	Highest Estate Tax Rate (%)	Gift Exemption (Million) $	Estate Exemption Unified or Credit Amount (Million) $	GST Tax Exemption (Million) $	Notes
2001	55	0.675	0.675	0.675	
2002	50	1.00	1.00	1.00* *Adjusted annually for inflation.	Estate tax exemption is raised to $1 million; top estate tax is cut to 50 percent
2003	49	1.00	1.00	1.00*	Top estate tax is cut to 49 percent
2004	48	1.00	1.50	1.50	Estate tax exemption rises to $1.5 million, top estate tax rate is cut to 48 percent
2005	47	1.00	1.50	1.50	Top estate tax is cut to 47 percent
2006	46	1.00	2.00	2.00	Exemption rises to $2 million; top rate declines to 46 percent
2007	45	1.00	2.00	2.00	Top rate declines to 45 percent
2008	4	1.00	2.00	2.00	No change
2009	45	1.00	3.50	3.50	Exemption rises to $3.5 million
2010	0	1.00	Repeal	Repeal	Estate tax is completely repealed
2011	55	1.00	1.00	1.00	The new tax law "sunsets" and all changes revert to before the new tax law, unless Congress amends the new law by this time

The gift tax will not be repealed. Instead, the new law creates a $1 million lifetime gift tax exclusion, starting in 2002. In 2010, the maximum gift tax rate will be 35 percent, which will be the top individual tax rate that year. Individuals are still allowed to give up to $10,000 annually to any person without paying a gift tax.

McGraw-Hill
Irwin

ISBN 0-07-283614-8

99991

9 780072 836141

www.mhhe.com

McGraw-Hill Higher Education
A Division of The McGraw-Hill Companies