

What's new

RETIREMENT

- Increases the amount you may contribute to a variety of retirement accounts.
- Creates a new "catch-up" feature to allow taxpayers over age 50 to save even more in employer-sponsored accounts like 401(k)s and SIMPLE plans.
- Gives low-income workers a credit worth up to 50 percent of the amount they save annually in IRAs and 401(k)s. Alert: This credit is available only 2002-2006.
- Starting in 2003, companies may provide accounts that allow tax-free withdrawals, similar to Roth IRAs.

EDUCATION

- Tax-free withdrawals from California Scholarshare and other "Section 529" college-saving plans, starting in 2002. Previously, withdrawals were taxed at the student's tax bracket.
- Creates a tax deduction for tuition and other qualifying college expenses. Alert: Cannot be claimed in same year as Hope or Lifetime Learning credit for the same student.
- Starting in 2002, you can save \$2,000 in Education "IRAs." Withdrawals are no longer taxed, and savings can be used for grades K-12, in both public and private schools. Income limits also were raised to allow more people to qualify.
- Allows considerably larger deductions for interest paid on student loans, as of 2002. No longer caps the deduction at \$2,500, allows deductions on interest paid after 60 months, and raises the income limits to allow more people to qualify.
- Allows private colleges and universities to sponsor prepaid tuition plans in 2004.
- Allows Hope and Lifetime Learning Credits to be claimed in same year that you tap an Education "IRA" in 2002.

ESTATE TAXES

- Repeals the estate tax in 2010. Alert: The estate tax will be restored in 2011 unless lawmakers extend the repeal.
- Until the estate tax is repealed, the bill rapidly increases the estate-tax exemptions so fewer estates will face tax, gradually trims the estate- and gift-tax rates to 45 percent by 2007, and eliminates the surtax on estates worth more than \$10 million.
- When the estate tax is repealed in 2010, inherited assets that are later sold will face capital-gains tax based on the fair market value at the time of original purchase — not at the time of death. Estates will be granted exemptions of \$1.3 million to \$4.3 million.
- The gift-tax exemption rises to \$1 million in 2002.
- Starting in 2010, the gift tax will be modified to restrict people from giving away highly appreciated assets to avoid capital-gains tax. Estates will have a lifetime exemption of \$1 million. (This will not affect annual gifts of \$10,000 or less.)
- Gradually trims the amount of the federal tax passed along to California and other states that don't have separate estate and inheritance taxes, starting in 2002. Alert: California could enact its own taxes to compensate for lost tax revenues, experts say.
- Modifies the generation-skipping transfer rules to ensure wealth is passed along with greater benefits. Eliminates the tax in 2010.

MORE DETAILS, PAGE 6E

Tax relief... and more headaches

The Tax Relief Reconciliation Act of 2001 could just as easily be called the "Financial Advisers Full Employment Act." So much is changing that even financial experts are struggling to take it all in, and to rethink accepted strategies to take advantage of the many features that phase in or phase out over the next decade.

- The bill, which phases in over 10 years and then dies, contains 85 major provisions and 441 Internal Revenue Code changes.
- The tax cut equals \$1.35 trillion.
- It's the largest tax cut in 20 years.
- \$875 billion of the cuts occur in the last 5 years.

How much will you save?

How much taxpayers in these scenarios would save under the new tax legislation, factoring in all available tax credits:

	Adjusted gross income	Tax yr 2001	Tax yr 2006
Single, no children	\$15,000	\$300	\$300
Single, one child	\$15,000	\$345	\$445
Single, no children	\$30,000	\$300	\$300
Married, one spouse working, two children	\$30,000	\$740	\$1,393
Single, no children	\$50,000	\$378	\$765
Married, both spouses working, two children	\$50,000	\$800	\$1,116
Single, no children	\$100,000	\$628	\$2,265
Married, both spouses working, two children	\$100,000	\$978	\$2,796
Single, no children	\$150,000	\$880	\$3,822
Married, one spouse working, two children	\$150,000	\$1,028	\$3,919

Source: CCH

FINANCIAL STRATEGIES

The new law may save you a lot of money over the next 10 years, but the revisions are complicated and require some planning.

When your tax ship comes in

CHANGES MAY PROVIDE MORE FUNDS FOR EDUCATION, RETIREMENT, HEIRS

By Mark Schwabhauser
 Mercury News

The \$1.35 trillion tax bill waiting for President Bush's signature this week will make it easier for Silicon Valley taxpayers to attain three of their most daunting financial goals. It offers ways to help you put your kids through school, stash away enough for a comfortable retirement and pass along whatever's left when you die.

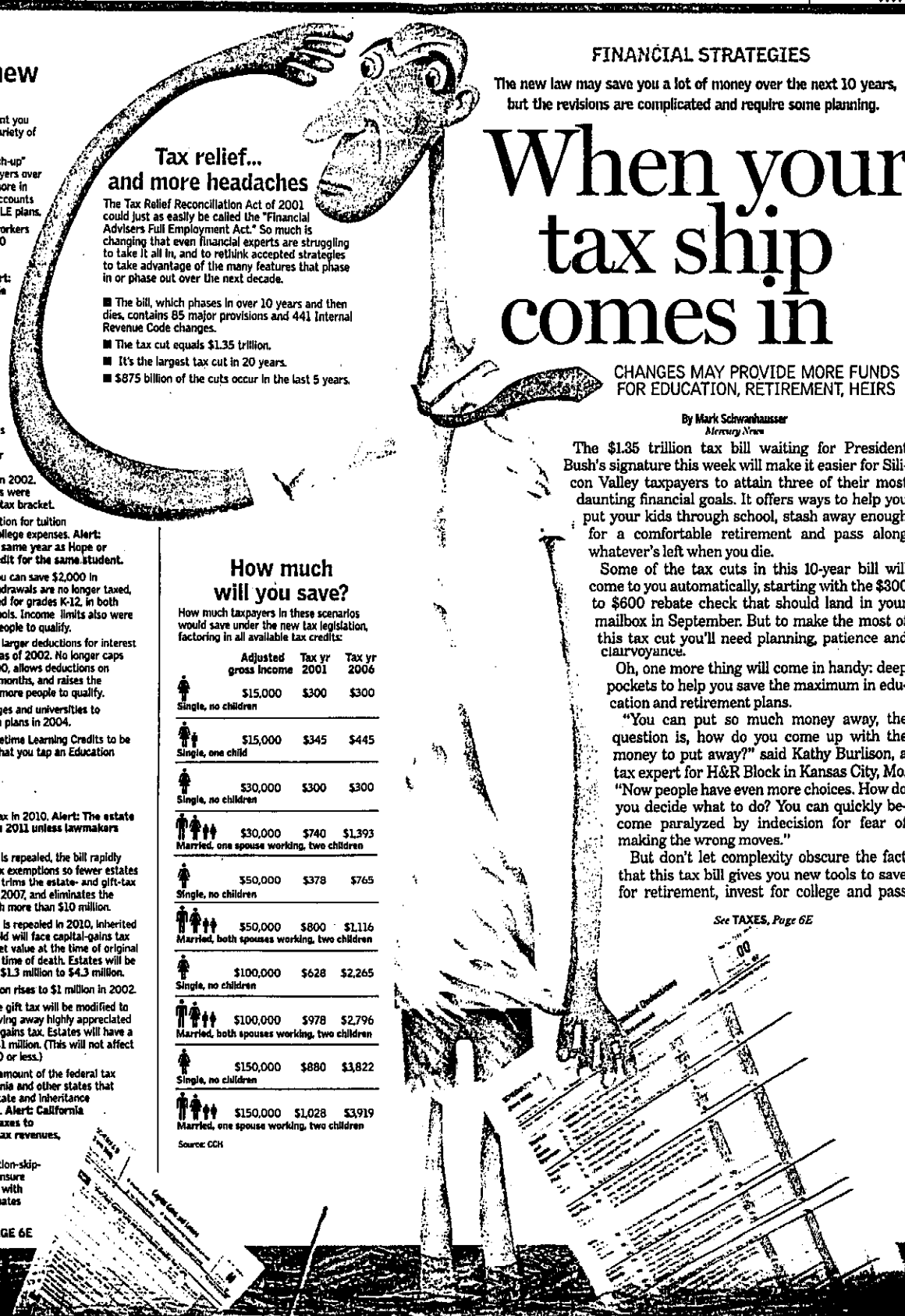
Some of the tax cuts in this 10-year bill will come to you automatically, starting with the \$300 to \$600 rebate check that should land in your mailbox in September. But to make the most of this tax cut you'll need planning, patience and clairvoyance.

Oh, one more thing will come in handy: deep pockets to help you save the maximum in education and retirement plans.

"You can put so much money away, the question is, how do you come up with the money to put away?" said Kathy Burlison, a tax expert for H&R Block in Kansas City, Mo. "Now people have even more choices. How do you decide what to do? You can quickly become paralyzed by indecision for fear of making the wrong moves."

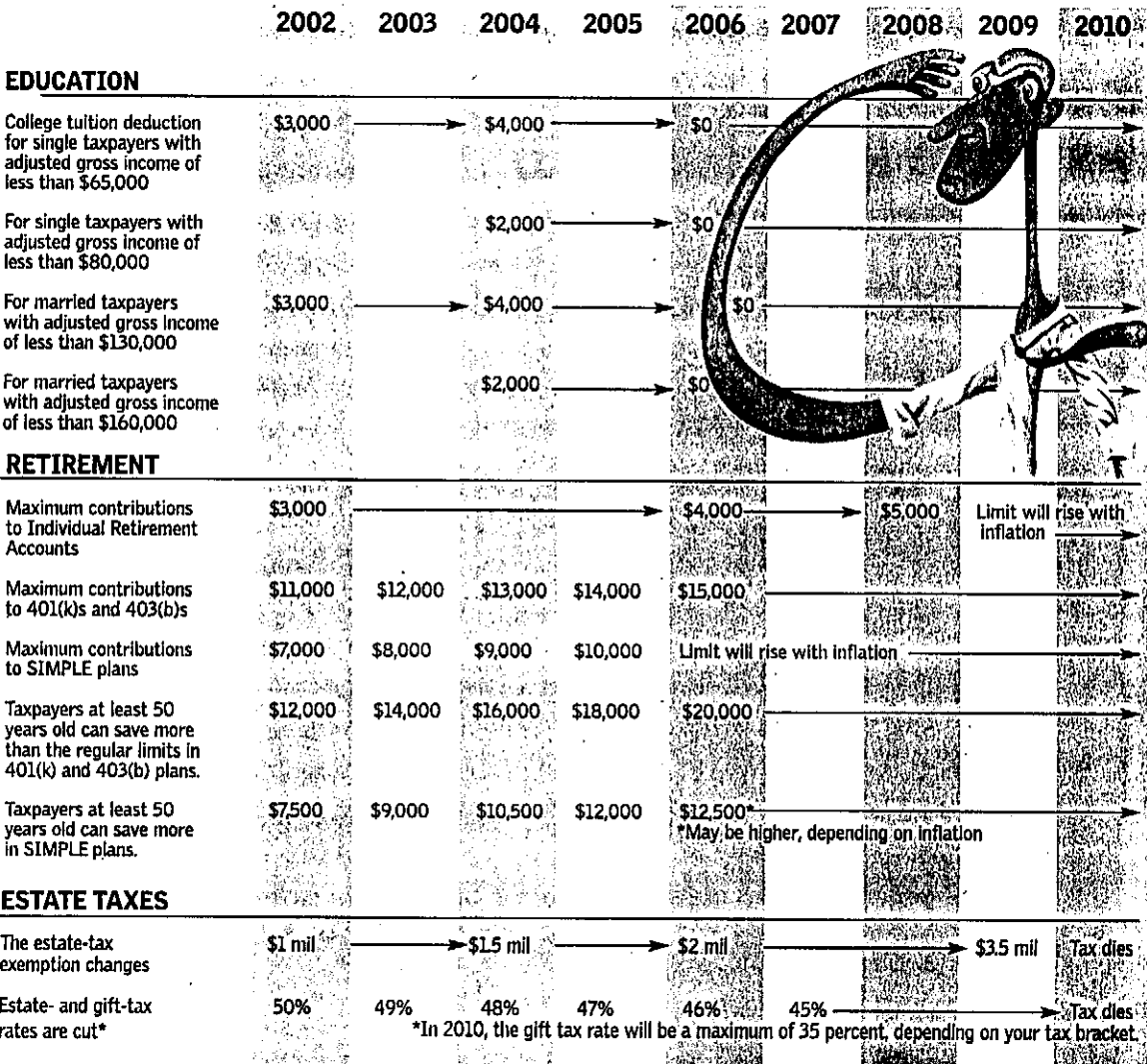
But don't let complexity obscure the fact that this tax bill gives you new tools to save for retirement, invest for college and pass

See TAXES, Page 6E



When some new tax cuts would be effective

Planning for college, retirement and the family inheritance are some of the concerns addressed in the tax bill President Bush is expected to sign this week. (For a look at what's new, see Business Page One). Here's when the changes in those areas would go into effect.



monly known as the Education IRA. Like 529 plans, withdrawals will be free of taxes. The amount you can save each year will rise from \$500 to \$2,000. But here's what's likely to appeal to many parents: The money can be used to pay for K-12 expenses — not just college — and it doesn't matter if your kid is in public or private school.

Of course, tapping these accounts for K-12 expenses like a computer will deflate the tax-deferred compounding — and compounding will work best for parents who start saving as soon as the child is born — but these accounts no longer can be easily dismissed.

But Congress didn't stop here. It also will allow parents to deduct — at least from 2002 through 2005 — some of their college tuition bills. It will allow many Americans strapped with college loans to deduct more interest. And it will make it easier to take more than one tax break for a single student in a given year. Starting in 2006 the college tuition break goes away.

Passing down estate

The most controversial component of the tax cut is the repeal of the "death tax." But don't think for a moment that taxes on inheritances will disappear or that estate-tax attorneys will hang up "Going Out of Business" signs. If anything, they are bracing for a deluge of business.

The biggest reason: uncer-

TAXES | Bill raises limits for retirement accounts

along your estate. Here's an overview:

Saving for retirement

Nearly half of the new tax provisions are designed to make it easier for you to squirrel away money for a comfortable retirement. The bill gradually raises the limits on how much you can stash in a variety of retirement accounts — from IRAs and Roth IRAs to employer-sponsored plans

such as 401(k)s and 403(b)s. It lets savings procrastinators catch up by permitting larger contributions during their peak earning years. And it offers compelling incentives to spur low-income workers to save.

Most important, the new law will allow many taxpayers to save twice what they can today. At various points over the next decade, Americans will be allowed to write off contributions of \$5,000 in an IRA and \$15,000 in a 401(k), deferring the taxes to when the money is withdrawn. Workers and owners of small businesses with SIMPLE plans will be able to save \$10,000. And

Americans who are at least 50 years old eventually will be able to boost their savings in SIMPLEs and 401(k)s to as much as \$12,500 and \$20,000 a year, respectively.

The biggest winners clearly will be Americans who can afford to save to the max. If you're on a tighter budget and already saving as much as you can, these new limits will be unattainable and you'll save nothing extra.

Still, low-income workers also will benefit from playing "what-if" just like wealthier taxpayers. For instance, the definition of earned income will change so that pretax money deducted from paychecks for 401(k)s and flexible-spending accounts will no longer be counted. That means increasing how much you save in those plans might help you qualify for a larger earned-income credit.

Whittling your income down this way also could help you qualify for a new tax credit that is linked to how much you save in these retirement plans. Done smartly, it's possible to increase your savings without trimming your take-home pay.

There is at least one strategy that might merit re-evaluating, however. Because income tax brackets will edge down gradually over the next decade, experts say it might be wise to postpone converting traditional IRAs into Roth IRAs. That way, the income triggered by the conversion will be taxed at a lower rate.

"Financial planners and individuals have to rethink their strategy," said Bob Trinz, editor of tax publisher RIA's

"We know what year people should be dying: That's 2010. You don't want to die the year before or the year after."

— MICHAEL B. ALLMON, CPA

"Federal Taxes Weekly Alert." "It changes the playing field."

Saving for education

Imagine combining the tax deferral of an IRA with the tax-free withdrawals of a Roth IRA. That's effectively what

Congress created when it retooled the rules for so-called 529 college savings plans and Education "IRAs."

The 529 plans — California's is called Golden State Scholarshare — were compelling even without this tax bill. Parents and grandparents may invest more than \$100,000. The money can pay for tuition and expenses at virtually any school in the nation. The investments are professionally managed by well-known companies, such as Fidelity, Vanguard and TIAA-CREF.

But the tax bill will provide the clincher: tax-free withdrawals.

"That is enormous," said Burlington. Added Debra Jorgensen, a certified financial planner with Merrill Lynch in San Francisco: "It's the best vehicle for saving for a kid's education."

Likewise, Congress drew up a new and improved Education Savings Account, com-

tainty.

On the face of it, taxpayers now hold a road map showing how the tax law will work for the next 10 years. In essence, the first nine years we'll operate under a less costly version of the current estate tax. In 2010, the estate tax will die. But in 2011, the repeal itself will die — and the current estate tax will rise from the grave.

"We know what year people should be dying: That's 2010," said Michael B. Allmon, a certified public accountant in Marina Del Rey. "You don't want to die the year before or the year after."

Of course, repeal is in the law — but laws could change by 2010. The changes must weather five Congresses, perhaps three presidents and the

Under the new rules, you might want to keep assets in the estate rather than handing them down early.

threat of recession and budget deficits. Politically, it's not likely lawmakers would let the repeal die after just one year — but some experts doubt repeal will occur in the first place.

In the meantime, experts say it's time for wealthier taxpayers to revisit their estate plans. Because the exemptions are rising, many will no longer need complex estate-planning strategies. But others must set up plans to account for death in pre- and post-repeal times.

For instance, experts are warning to hold off making gifts that exceed a lifetime total of \$1 million. (This does not affect annual gifts less than \$10,000.) Under the current

rules, you give away highly appreciated property so that it will be taxed at your beneficiary's tax bracket, rather than lose 55 percent to estate taxes.

But under the new rules, you might want to keep those assets in the estate — where they might be protected from tax by the increased exemption — rather than handing them down early and exposing them to income tax.

"The uncertainty we're talking about is not going to be resolved in the next few days, weeks or even years," Allmon said. "Uncertainty is hard to deal with. There's not a consistent conclusion on the part of advisers on how to handle things yet."

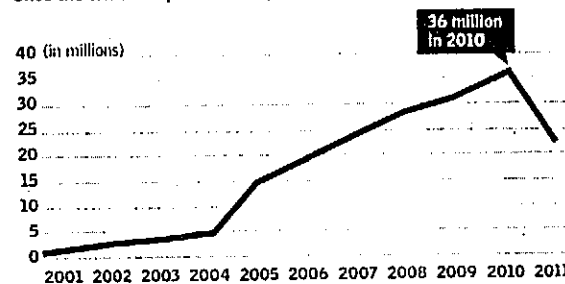
Contact Mark Schwanhauser at mschwanhauser@sjmercury.com or (408) 920-5543.

"For people who already are in AMT, the tax cut is really smoke and mirrors. They will likely get no benefit."

— Ellie Kelmeler
Tax director, Deloitte & Touche in San Jose

More middle-class taxpayers will owe AMT

The AMT will snare dramatically more taxpayers because lowering the regular tax liability increases your risk that you'll owe the AMT instead. And taxpayers who already owe AMT will enjoy virtually no tax cut. In 2010, an estimated 36 million taxpayers will owe AMT. Once the tax cut expires in 2011, AMT will snare only 21 million.



What's new

- Ratchets up the AMT exemption by \$2,000 for single taxpayers, \$4,000 for joint filers. This increase is eliminated in 2005.
- Because tax credits can throw taxpayers into the AMT, lawmakers previously had carved out a handful of temporary exceptions. This bill makes those exceptions permanent for the child tax credit, the refundable child credit and the adoption credit.

Source: Joint Committee on Taxation