

Tax Law Changes

June 1, 2001

As Director of Personal Income Tax Services at MDE, part of my responsibility is to communicate with our client family about changes in the tax environment. I have provided you below with some information about tax law changes that are likely to occur over the near term. I will also continue to monitor potential changes and inform our clients as they occur.

Final approval has been given for a 10-year \$1.35 trillion tax-cut plan. President Bush is expected to sign this bill sometime the week of June 4th after Congress returns from recess. "What is especially significant about the tax relief package...is that it cuts income taxes for everyone who pays them. Nothing could be more profound, and nothing could be more fair," President Bush said on May 26th.

Following is a summary of the major points included in the Economic Growth and Tax Relief Reconciliation Act of 2001:

- **Across-the-board cut in income tax rates:** there is a retroactive to January 1 tax cut from 15 to 10 percent for the first \$12,000 of income earned by joint filers, \$6,000 for single filers. This cut will result in a refund check being issued to all eligible taxpayers by October 1. All other rate cuts will occur gradually. Below is a table summarizing the rate cuts.

Calendar Year	28% reduced to	31% reduced to	36% reduced to	39.6% reduced to
2001-2003	27%	30%	35%	38.6%
2004-2005	26%	29%	34%	37.6%
2006 and later	25%	28%	33%	35%

- **Phase-out of itemized deductions and personal exemptions:** the overall limitation of itemized deductions will be eliminated for taxable years beginning after December 31, 2009. Beginning in 2006 and 2007, the limitation is reduced by one-third, and by two-thirds in 2008 and 2009. This same schedule is used for the phase-out of restrictions on personal exemptions.
- **Increase and expansion of child tax credit and dependent care credit:** for those eligible for the child tax credit, it will be gradually increased from \$500 to \$1,000 over the next ten years. For tax years beginning after December 31, 2001, the credit is increased from 30% to 35% and increases the amount of employment-related dependent care expenses from \$2,400 to \$3,000.
- **Marriage penalty relief:** married couples who do not itemize will receive a standard deduction twice that of a single filer. This increase is phased in over five years beginning in 2005. Married couples will also benefit from an increase in the amount of income taxed in the 15% income tax bracket. The bracket increase will be phased in over a four-year period beginning in 2005.
- **Increase in IRA contribution limits:** the annual IRA contribution limit will increase to \$3,000 in 2002, \$4,000 in 2005 and \$5,000 in 2008. After 2008, the annual limit will be

adjusted annually for inflation. In addition, taxpayers over age 50 will be allowed to make additional catch-up contributions.

- **Increase in contributions to defined benefit plans:** annual contributions to defined benefit plans will be increased from the current \$35,000 limit to \$40,000.
- **Salary reduction catch-up contributions under 401(k) plans:** individuals who are age 50 by the end of the year may make additional catch-up contributions to their 401(k) plans. The additional amounts are \$1,000 in 2002, \$2,000 in 2003, \$3,000 in 2004, \$4,000 in 2005 and \$5,000 in 2006 and later.
- **Education IRAs:** the annual limitation on education IRA contributions will be increased from \$500 to \$2,000. Qualified education expenses will now include elementary and secondary school expenses as well. In addition, the new AGI phase-out range for contributions by married couples increases to \$190,000-\$220,000.
- **Qualified tuition programs:** to the extent that distributions from a qualified tuition plan are used to pay for qualified higher education expenses, the distributions are excluded from gross income. This exclusion is effective for taxable years beginning after December 31, 2003.
- **Phase-out and repeal of estate and generation-skipping transfer taxes:** below is a table summarizing the schedule for the phase-out and repeal of the estate tax.

Calendar Year	Estate Tax Exemption	Highest Tax Rate
2002	\$1 million	50%
2003	\$1 million	49%
2004	\$1.5 million	48%
2005	\$1.5 million	47%
2006	\$2 million	46%
2007	\$2 million	45%
2008	\$2 million	45%
2009	\$3.5 million	45%
2010	n/a	35% (gift tax only)

- **AMT relief:** for 2001-2004, the AMT exemption amount is increased by \$4,000 for joint filers, \$2,000 for single filers.
- **Sunset provision:** all provisions of the bill generally do not apply for taxable years beginning after December 31, 2010 to ensure compliance with the Congressional Budget Act of 1974 unless re-ratified by Congress.

We have only given a summary of various points contained in the Economic Growth and Tax Relief Reconciliation Act of 2001. If you would like further information on the bill or have any questions regarding any of the provisions contained in the bill, please do not hesitate to call us. Of course, your MDE advisory team will be working on an ongoing basis to help you to design strategies to take advantage of these changes.

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