

TAX RELIEF 2001

*Here today, here tomorrow ...
 but maybe not in 2011!*

The largest tax cut in two decades has made its way through Congress with—by Washington standards—blinding speed. Known as the Economic Growth and Tax Relief Reconciliation Act of 2001, this incredibly broad legislation offers tax savings of various kinds to nearly all tax-paying Americans.

However, before you start planning what to do with your newfound tax savings, you need to be aware of some of the not-so-usual aspects of this new act:

- Some provisions are phased in over a number of years.
- Other provisions do not take effect until much later.
- **“Sunset” provisions will cause all the new tax breaks to disappear in 2011 unless re-enacted into law at that time.**

A Jump Start for the Economy

Rebate checks for all taxpayers

Anyone who paid federal income tax in 2000 is due a rebate check by the new act. Rebates are up to \$300 for singles and married persons filing separately, \$500 for heads of households, and \$600 for married couples filing jointly. Reason: The source of the rebates is a new 10 percent federal income-tax bracket—down from 15 percent—on the first \$6,000 of taxable income for singles and married persons filing separately, \$10,000 for heads of households, and \$12,000 for married couples filing jointly.

How Do You Rate?

Income-tax rates fall over the next five years

Federal tax brackets (with the exception of the 15 percent bracket) dropped by 1 percent, effective July 1, creating “blended” rates that reflect a half-point drop in 2001 and creating effective rate brackets of 27.5 percent, 30.5 percent, 35.5 percent, and 39.1 percent. The rates continue to drop until 2006. (See chart.) ▶

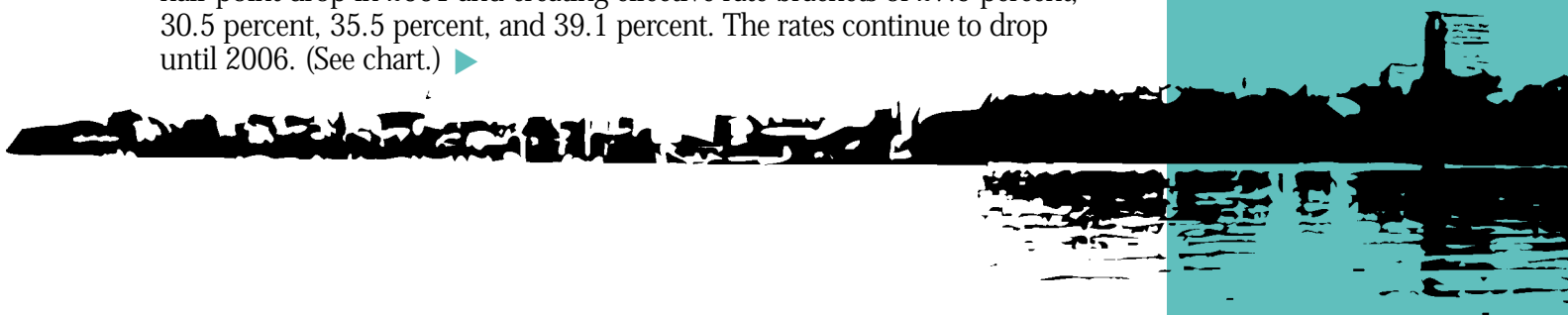
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AMT: Congress Giveth ... and Taketh Away

Taxpayers subject to the alternative minimum tax may be disappointed to learn their tax breaks may not be as large as those subject to the regular tax. The AMT was designed as an alternate method of calculating tax to keep taxpayers from benefiting from too many tax breaks. Those subject to the AMT will be able to exempt an additional amount from the tax starting this year (\$4,000 for couples, \$2,000 for singles), but that additional exemption disappears after 2004—cutting their already-reduced tax savings even more.

The AMT now (ironically) rarely affects those with the highest income—but rather impacts those with middle and upper-middle incomes. Warning: Because the AMT has not been adjusted in light of lower rates under the new act, it is estimated that the number of taxpayers subject to the AMT could increase from the current 1.5 million to more than 35 million by 2016.

Calendar Year	28% rate reduced to:	31% rate reduced to:	36% rate reduced to:	39.6% rate reduced to:
2001*- 2003	27%	30%	35%	38.6%
2004 - 2005	26%	29%	34%	37.6%
2006 and later	25%	28%	33%	35%
*Effective July 1, 2001				

Charitable planning pointer: All other things being equal, your deductions are worth more in 2001 than in any other year in the foreseeable future, since tax rates will continue to fall. Perhaps your most flexible deductions are your charitable contributions. If you are planning a gift in the near future, it might make sense to make it this year.

Phase-out of limits on itemized deductions. Currently, itemized deductions must be reduced by 3 percent of adjusted gross income in excess of \$132,950. The new act trims the reduction by one-third in 2006 and 2007 and by two-thirds in 2008 and 2009 and completely eliminates it after 2009. Planning note: Delaying deductions until this provision kicks in will generally produce no additional savings. Even though the deductions will be fully usable after 2009, they will produce less tax savings due to lower tax rates.

ACTION ALERT

- Accelerate deductions to take advantage of higher tax savings in the early years of the tax reductions.
- To the extent possible, consider delaying income until later years. For example, delay billing clients until late in the year, or choose income investments that delay crediting of interest until next year.
- Re-evaluate your charitable-giving plans. You may actually have more available for charitable purposes because of lower income taxes and lower estate taxes on bequests to individual beneficiaries.

Going, Going ... Gone?

Federal estate tax phased out by 2010—but could be back

Much of the fanfare surrounding the new tax act focuses on the gradual reduction and eventual repeal of the federal estate tax. Indeed, the impact of the new law is impressive.

Under the current system, a person dying today with a taxable estate of \$10 million would owe \$4,920,250. The tax on that same amount will drop to \$3,680,000 in 2006 and to \$2,925,000 in 2009. In 2010, there will be no tax at all. The savings come in two ways:

- Gradual reduction and eventual elimination of the maximum effective estate-tax rates that currently go as high as 60 percent.
- Increases in the “exemption equivalent”—the amount that can be passed on free of transfer tax. That amount is currently \$675,000 and will go up to \$3.5 million in 2009 before the tax disappears in 2010. The tax will be back in 2011 unless the repeal is re-enacted all over again.

Rates will be cut and the exemption will grow according to the following table:		
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	Estate Tax Repealed	

Repeal brings modified carryover basis. When property passes at death under the current tax system, its “basis” in the hands of the recipient is generally its fair-market value at the time of death.

This “stepped up” basis system will remain in place until the estate tax is repealed in 2010, when each estate will be allowed a stepped-up basis

of up to \$1.3 million (property passing to a surviving spouse will qualify for an additional \$3 million). The basis of all other property will carry over from the basis of the decedent.

Note: Gift tax to stay. In 2004 the estate-tax exemption rises to \$1.5 million, but the gift-tax exemption **remains at \$1 million**, where it will stay permanently. The maximum gift-tax rate in 2010 will be equal to the top individual income-tax rate of 35 percent.

Advantages of lifetime charitable gifts. As the amount exempt from federal estate tax climbs over the next several years, more people may find charitable gifts during their lifetimes to be advantageous. Depending on the size of a taxpayer's estate, a transfer at death may provide no tax savings, while a gift during life generates substantial current income-tax savings.

Supplement New Retirement-Savings Opportunities with Charitable Options

The new law increases maximum allowable contributions to IRAs and other types of retirement plans. Maximum annual deductible limits for IRAs will grow from the current \$2,000 to \$5,000 in 2008. Persons aged 50 and older will be able to make additional “catch up” contributions of \$500 next year, growing to an additional \$1,000 in 2006. Limits for certain other plans such as 401(k), 403(b), and 457 plans will increase over time to \$15,000. In many cases, persons aged 50 and older will be allowed to make contributions up to \$20,000.

Better yet, for participants in some plans, the new act creates a Roth IRA counterpart, allowing nondeductible contributions that can later be withdrawn tax-free. Virtually all employees covered by a 401(k) or 403(b) plan will be eligible to make these elective contributions, starting in 2006.

Some taxpayers may not be eligible for these additional retirement-savings options, while others may still feel the need for more retirement security. Those with significant charitable objectives may benefit by addressing both of these concerns at the same time.

Planning Still Pays

Do not be lulled into thinking that the new tax law eliminates the need for estate planning. As always, there are many nontax reasons for planning, including:

- Deciding who your beneficiaries will be and how much each will receive, especially if you want to designate non-family-members or charities.
- Establishing trusts to manage assets and control the amount and timing of distributions.
- Selecting persons who will be empowered to act on your behalf if you are unable.
- Designating those who can make health-care decisions if you cannot, and expressing your wishes on the use of life-prolonging measures.
- Choosing guardians for surviving minor children.

Whether you are married or single, if your estate currently exceeds \$675,000, you will need to review your estate plans frequently during the next decade.

The new tax act is incredibly broad, and the degree to which it reaches out into the future to effect change is unprecedented. It demands a higher degree of planning vigilance for a longer period of time than any previous tax legislation. ■

ACTION ALERT

- Check out any new retirement-saving opportunities that apply to you.
- Analyze whether tax-deductible or “Roth” type plans that return tax-free income are better for you.
- Consider charitable life-income plans to supplement retirement income.

New Regulations for IRA and Retirement Plan Distributions

In January 2001, the Internal Revenue Service issued proposed regulations that would simplify the rules for distributions from IRAs and qualified retirement plans. If these regulations are adopted as expected, they would apply to calendar years beginning on January 1, 2002. For distributions in calendar year 2001, you can rely either on the new rules or follow the existing ones. IRA account holders can rely on the regulations immediately, while 401(k) and other retirement plan participants must wait until their specific plan is amended.

Here are some ways you could benefit from the new regulations:

- **Simpler minimum distribution calculation.** Instead of the existing “term,” “recalculation,” and “hybrid” methods, the new rules provide a single, quite favorable method of computing minimum distributions required to begin April 1 following the year you attain age 70^{1/2}.
- **More flexible beneficiary provisions.** Unlike the old rules, the regulations allow you to substitute or add beneficiaries—persons or charitable organizations—without affecting the minimum withdrawal rate. Beneficiaries now also can choose whether to be cashed out, disclaim their interests, or receive payments for life.
- **Minimum withdrawal amount likely reduced.** In many cases, the regulations will extend the withdrawal period for minimum distributions, allowing you to take less out of your account each year and leave more for tax-deferred growth.
- **Beneficiary choice no longer affects minimum distribution amounts.** Your choice of beneficiaries—an individual of any age or a charitable organization—no longer affects your minimum distribution amount.

You should consult your attorney about the applicability to your own situation of the legal principles contained herein.

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