



TAX REFORM PROVISIONS



President Bush signed into law the “**Economic Growth and Relief Reconciliation Act of 2001**” in mid-June. Thanks to a distinctly bipartisan effort, the bill contained a little less tax cutting than the Republicans favored, and a little more than the Democrats desired. This Act forms the largest tax cut in 20 years in pure dollars,

\$1.35 trillion. It has 85 major provisions and 441 Internal Revenue code changes, and the official text stretched 291 pages.

Most significantly, the **EGRRA** of 2001 is distinctly back-loaded. Most changes are phased in over the next 10 years. It is important to keep in mind that in that time period, we will have two more presidential elections. Intervening legislation can, and no doubt will, modify some of the Act’s provisions. From this perspective, it is nonetheless important that we begin our personal planning with an understanding of the Act’s current provisions.

The major impact of the **EGRRA** of 2001 to investors focuses on three areas:

1. Income tax rate cuts
2. Estate tax relief
3. Retirement savings reform

Additionally, enhancements were made to child, adoption and dependent-care tax credits. Eventually, the “marriage penalty” will be eased. Lastly, benefits for people saving and paying for education for themselves and their families were included. We will focus on the three elements listed that most directly influence the investor.

TAX CUTS

Virtually all investors will receive the benefits of a gradual reduction in marginal rates and the creation of a new tax bracket. A 10% rate is carved out of the 15% bracket applying to the first \$6,000 (\$7,000 in 2008 and after) for single taxpayers and \$12,000 for joint returns (\$14,000 in 2008 and beyond). This new tax bracket reduction of 5% is retroactive to the beginning of 2001 and results in immediate savings of \$300 (5% of \$6,000) for singles and \$600 for joint filers. A check will be in the mail for you over the next few months if you paid your 2000 taxes in a timely manner. It is hoped that this early tax refund will provide a stimulus to the U.S. economy, kick-starting a recovery expected in late 2001. Enjoy spending your money the government is returning to you!

Other rates are reduced beginning July 1, 2001, and are gradually phased in over the next decade. The new rates are shown below.

Current Rates	28%	31%	36%	39.6%
June 30, 2001 through 2003	27%	30%	35%	38.6%
2004 through 2005	26%	29%	34%	37.6%
2006 and thereafter	25%	28%	33%	35%

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RETIREMENT SAVINGS AND PENSION REFORM

ESTATE TAX RELIEF

Perhaps nothing is more important to the proper transfer of wealth than the implications of the federal estate tax. The last few years have seen an upsurge in the desire to eliminate the so-called "death tax" rather than use it to allow the government to redistribute the wealth created by its citizens. The EGRRA slowly reduces the effects of the estate tax and eliminates it altogether in 2010, for one year. In 2011, this entire section reverts back to its present status if no further legislation ensues. This unusual provision of reversion obviously creates uncertainty and impedes the planning process.

Estate tax relief comes from a slight reduction in marginal rates and exemption from tax for increasing estate sizes. From the current individual exemption of \$675,000, the exemption rises through 2011 as follows:

2002 and 2003	\$1,000,000
2004 & 2005	\$1,500,000
2006 through 2008	\$2,000,000
2009	\$3,500,000
2010+	estate tax repealed
2011	\$1,000,000

In 2010, while the Act repeals the estate tax, it eliminates the "stepped-up basis" of current law and thus introduces capital gains tax implications on the sale of inherited assets. This creates huge record-keeping demands for any and all assets. Smaller estates of \$1.3 million or less (\$3 million if passed to a spouse) will not face this capital gains situation on most assets.

As flawed as the ACT is in the uncertainty beyond 2011, it does provide great relief over the next decade. In five years, it will be possible for a married couple to pass \$4 million estate tax-free to their heirs. This will certainly lessen the onerous results of current tax law. In light of these changes, it is very important to review current wills and testamentary trust documents. Please see your estate-planning professional soon.

As the baby boomers race toward retirement, the EGRRA has created greater incentive and ability to save for future needs. The cost of this portion of the reform is expected to be about \$50 billion. A small price to pay to encourage people to prepare for a dignified retirement.

IRA contribution limits, now \$2,000, are increased to \$5,000 for both traditional and Roth IRAs (\$3,000 for 2002-2004; \$4,000 for 2005-2007; \$5,000 for 2008) with annual inflation adjustments after 2008. If possible, one should definitely maximize contributions. The reduction in tax rates may further increase the relative attractiveness of Roth IRA contributions.

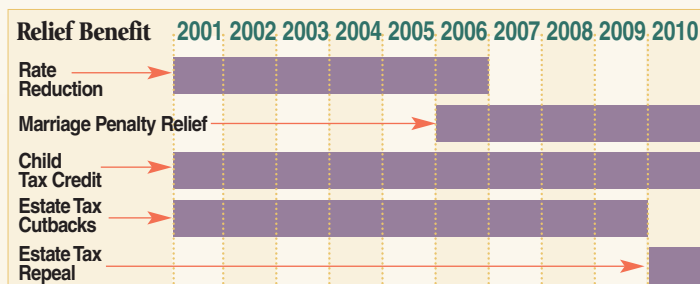
"Catch-up" contributions have been introduced to allow taxpayers who are 50 years old and older to contribute an extra \$500 annually in 2002-2005 and \$1,000 thereafter. These extra contributions can go to either a traditional or Roth IRA as long as the middle-aged taxpayer meets baseline limits for regular contributions.

401(k) contributions will likewise be increased from \$10,500 to \$15,000 (\$11,000 in 2002 increased annually by \$1,000 through 2006; indexed thereafter).

Simple IRAs become even more attractive with elective deferrals rising to \$10,000 from the current \$6,000 (\$7,000 in 2002 increased by \$1,000 annually through 2005; indexed thereafter). "Simple" plans are very attractive to small employers as they are very affordable and require little administration.

Backloaded Timing of Tax Cuts —Phase-In Periods—

Tax cuts in the 2001 Tax Act span 10 years and carry a variety of starting and phase-in dates:



This historic tax relief measure provides something for virtually everyone. It does challenge us all to re-examine our objectives, plans and processes to take full advantage of its provisions. Importantly, we cannot remain passive, but must be proactive in our approach.