



**Accutek Solutions**  
Doug Beecher, C.P.A.

51 North 1000 West, Suite 5  
Hurricane, UT 84737  
Tel: (435) 635-3684  
Fax: (435) 635-5454  
E-mail: dougbeecher@yahoo.com  
Website: www.accuteksolutions.com

## **November 2001 - Save With The 2001 Tax Law Changes! (Part 2)**

There are more aspects to this law than can be discussed in a single article. This article explores changes in education IRAs, education expense deductions, changes in IRAs and other retirement savings plans, as well as itemized deduction and personal exemption phase-outs. Future articles will consider more of the tax law changes.

### Education IRA Changes

Current law allows contributions of up to \$500 by the end of each year for higher education expenses. No tax deduction is allowed for these contributions, the benefit comes from tax-free earnings growth and tax-free withdrawals if the money is used for qualified higher education expenses. Contributions can be made for any person who has not reached age 18.

Beginning in 2002, the contribution limit increases to \$2,000 and can be used for qualified elementary and secondary school expense in addition to higher education expense. The contributions deadline for 2002 will be extended to April 15, 2003 (rather than year-end), and will stay at April 15 for later years beyond 2002.

Contributions can be transferred tax-free from one beneficiary to certain family members under age 30. This can help to avoid taxes and penalties that are due on withdrawals in excess of qualified education expenses and excess contributions left in the account. There are also phase-out rules for taxpayers above income levels as low as \$95,000, so be sure to get professional advice before using the Education IRA to make sure it will be beneficial in your specific situation.

### Education Expense Deductions

Current law has Hope and Lifetime Learning education credits. The Hope credit is the most generous, but it can only be used for the first two years of higher education. It is a direct dollar-for-dollar credit up to the first \$1,000 in tuition and fees per student, and then is a 50% credit for the next \$1,000, so that the maximum credit is \$1,500. The Lifetime Learning credit is 20% of tuition and fees, up to the first \$5,000 per tax return. Note the difference between the maximum credit per student on the Hope plan and the maximum credit per tax return on the Lifetime Learning credit. Both credits have income limits, they begin phasing out at only \$40,000 for single, head of household, qualifying widow(er), and \$80,000 for married filing jointly. If you are married filing separately, you cannot claim the education credits.

The 2001 Tax Law keeps both the Hope and Lifetime Learning credits, with all the features and rules just described, and adds another choice – the education expense deduction. This is a deduction, not a credit, so its value is the amount of the deduction times the income tax bracket you are in. If your tax bracket is 27.5%, a \$3,000 deduction would be worth \$825 in tax savings. For some people one of the credits will be better, for others the deduction will be better, so be sure to calculate it each way to make sure you are getting the best way for you. Once again, professional help is advisable.

The educational expense deduction is temporary, running from 2002 to 200 only. Of course, it could be renewed later by a future Congress. It has different income limits and maximums for the following years: (Note that these income limits allow some who cannot take the credits to qualify for the deduction)

<u>Year(Maximum Deduction)</u>	<u>Income Limit</u>	
	<u>Single, Head of Household</u>	<u>Married Filing Jointly</u>
2002-2003 \$3,000	\$65,000	\$130,000
2004 \$4,000	\$65,000	\$130,000
2005 \$2,000	\$80,000	\$160,000

### IRA and Other Retirement Plan Changes

Several enhancements were made in IRA plans in the 2001 tax law to help encourage more people to save larger amounts for retirement in these plans.

The maximum contribution is increased beginning in 2002 to \$3,000 per person. In 2005 it goes up again to \$4,000 per person, and in 2008 another increase brings the maximum contribution to \$5,000 per person. After 2008 the maximum contribution will be adjusted for inflation in \$500 increments. Note that for many married couples, both can contribute up to these maximum amounts, effectively doubling the amount they can save and invest towards retirement.

Special additional "catch-up" contributions will be allowed for those who have reached age 50. In 2002-2004, the maximum contribution will be \$500 higher for those age 50 and up. Beginning in 2005 and thereafter, the maximum contribution will be \$1,000 higher for those age 50 and up.

The income limit for those participating in an employer-sponsored retirement plan is increased. In 2001, single people earning up to \$33,000 and those married filing jointly earning up to \$53,000 can make fully deductible IRA contributions even if they also participate in a retirement plan at work. Note that in some cases, one partner in a marriage is covered by a retirement plan at work, and the other is not. They have higher limits than those discussed below, which are beyond the scope of this article, but ask for help because they might be very beneficial for you! There is also an exception to the rules for certain volunteer firefighters participating in a government plan, again ask for specific details if this might apply to you! The general income limits are increased for future years as follows:

### Income Limits

<u>Year</u>	<u>Single</u>	<u>Married Joint</u>
2002	\$34,000	\$54,000
2003	\$40,000	\$60,000
2004	\$45,000	\$65,000
2005	\$50,000	\$70,000
2006	\$50,000	\$75,000
2007+	\$50,000	\$80,000

A new credit for IRA contributions is added for 2002 through 2006. Eligible taxpayers may claim a tax credit of up to 50% of their qualified contributions to an IRA, 401(k), SIMPLE, SEP, 403(b), and eligible 457(b) plans, up to a maximum of \$2,000 of contributions. This credit is non-refundable, which means it is limited to the amount of income tax owed and will not provide you a refund if the credit would otherwise be larger than the amount of income tax owed. It also means that it cannot be used to offset self-employment tax.

Significantly, this new credit offsets alternative minimum tax liability as well as regular tax liability. The credit is in addition to any deduction that you receive for the qualified IRA or other retirement plan contribution.

If you have an interest in saving more seriously towards retirement, now would be a fantastic time to begin. This is just the beginning of the retirement plan provisions in the 2001 Tax Law, so please ask if this generates additional questions on the subject.

## Repeal of Itemized Deduction and Personal Exemption Phase-out

Current law allows for the phase-out of itemized deductions for taxpayers with adjusted gross income (AGI) above an amount adjusted each year for inflation. For 2000 tax returns, this AGI level was \$128,950 for single, head of household and married taxpayers filing joint returns. For married taxpayers filing separate returns the AGI level was \$64,475.

Personal exemptions were also phased out beginning at the following AGI levels on 2000 tax returns:

Single	\$128,950
Head of Household	\$161,150
Married Filing Jointly	\$193,400
Married Filing Separately	\$ 96,700

These phase-outs provided Congress another way to increase effective tax rates for "high incomes" without having to increase the rates themselves. For example, for someone in the 39.6% bracket, it effectively made the tax rate at least 41.6%. Parents who lost the personal exemptions for their dependent children in addition to losing their own personal exemptions would face additional 0.8% effective tax rate increases for each dependent lost. (So a family of 6 could see an effective tax rate of 45.6%, not including Medicare and state income taxes, which often pushed the total burden above 50%).

The 2001 tax law will gradually restore the full benefit of itemized deductions and personal exemptions regardless of income level. Patience will be required, however, as the first benefit will not occur until 2006, when the phase-out amount will be reduced by one-third. Two years later, in 2008, the phase-out amount will be reduced by two-thirds. It will take until 2010 for the phase-outs to be totally repealed. Postponing income as long as possible will help you take the greatest advantage of this repeal.

**The information in this article is intended to inform you of some of the tax savings opportunities available in the 2001 tax law. It is not intended to give you specific tax advice for your personal situation. If you need such advice, please contact a qualified professional!**

If you have a question you'd like to have answered in a future article, please contact me at 435-635-3684 or by e-mail at [dougbeecher@yahoo.com](mailto:dougbeecher@yahoo.com)