

## Some terrific savings incentives

# The 2001 tax law and



**The headlines talk mostly about income tax cuts.** Nice. But that's only part of what "The Economic Growth and Tax Relief Reconciliation Act of 2001" is about. This complex, broad-ranging legislation includes some juicy tax incentives to promote saving. However, the news is not all good. What follows is a brief summary of just some of the highlights of the new law, provided for AAFP courtesy of Dearborn Financial Publishing.<sup>1</sup>

**Cutting right to the bad news: The entire package "sunsets"** on December 31, 2010. At that time, unless Congress acts, the law expires and taxes revert to today's levels. Example: Estate taxes gradually shrink over the decade, phased out completely in 2010. Under the new law's sunset provision, however, estate taxes return in 2011. This makes it virtually impossible to do estate planning, unless you know when you intend to die.

**More on estate taxes:** Today's top rate of 55% gradually declines, while the exemption of \$675,000 gradually increases. This means, if you die in this decade, more of your estate should go to your heirs, less to Uncle Sam. However, there are some "carryover basis" provisions that could saddle your heirs with capital gains.

Still, there's much good news, including some attractive incentives to save money:

- **IRA contribution increases.** The contribution maximums for both Roth and traditional IRAs rise from the current \$2,000-a-year to \$5,000 by 2008 (\$10,000 for couples).
- **Catch-Up provisions for older IRA owners.** Starting in 2002, if you are 50 or older, you can make additional contributions to your IRAs beyond the new limits. The Act did not, however, make any changes to the income limits that apply to being able to deduct traditional IRA contributions or make Roth IRA contributions. The catch-up contribution limits are as follows:

YEAR	IRA MAX CONTRB	CATCH-UP CONTRB (AGE 50 +)
2001	\$2,000	ZERO
2002	\$3,000	\$ 500
2003	\$3,000	\$ 500
2004	\$3,000	\$ 500
2005	\$4,000	\$ 500
2006	\$4,000	\$1,000
2007	\$4,000	\$1,000
2008+	\$5,000	\$1,000

- **Increases in qualified employer plans.** Contribution limits for 401(k) plans, 403(b) plans and salary reduction SEPs will increase from \$10,500 to \$15,000 by 2006. Additionally, maximum annual deferrals to SIMPLE plans will increase from \$6,000 today to \$10,000 by 2005.

Plus, beginning in 2002, the limit on annual additional payments to a defined contribution plan will increase to \$40,000 (from \$35,000); the annual limit on benefits paid under a defined benefit plan will rise to \$160,000 (from \$140,000).

Finally, as with IRAs, qualified plan participants over age 50 can increase their elective deferrals in qualified plans under a catch-up provision. The amounts will rise to \$2,500 a year by 2006 for 401(k) and SIMPLE Plans and \$5,000 for other qualified plans.

- **Education IRAs.** The current maximum contribution to an education IRA is \$500. Eligibility is phased out for taxpayers with adjusted gross incomes between \$95,000 and \$110,000 (\$150,000 and \$160,000 for joint filers). Under the new law, annual contribution limits increase to \$2,000 a year in 2002. Plus, the accounts can be used for elementary and secondary education expenses, not just post-high school. Also, eligibility phase-out will begin at \$190,000 for joint filers. (See the related article, this issue, on Section 529 Plans, another attractive education funding vehicle.)

**Conclusion:** As with any new tax law, it will take some time for the IRS, accountants and the courts to decipher the fine print meaning of many of its provisions. In the meantime, take advantage of the new accumulation limits. But first, be sure to talk to your tax advisor. ■

YEAR	TOP RATE	EXEMPTION
2001	55%	\$ 675,000
2002	50%	\$1,000,000
2003	49%	\$1,000,000
2004	48%	\$1,500,000
2005	47%	\$1,500,000
2006	46%	\$2,000,000
2007	45%	\$2,000,000
2008	45%	\$2,000,000
2009	45%	\$2,000,000
2010	ZERO	NOT APPLICABLE
2011	55%	\$1,000,000

<sup>1</sup> Quick Reference Guide to The Economic Growth and Tax Relief Reconciliation Act of 2001 (Dearborn Financial Publishing, 2001)



# and A **about disability insurance**

## Ten Important Questions

**Disability insurance is sometimes referred to as the “forgotten need.”**

That is because, while people recognize the importance of medical and life insurance, they often overlook the need for disability insurance. What follows are some important questions you should consider:

**1 Who needs DI coverage?** In all likelihood, if you earn an income, you do. DI coverage insures your income-earning ability. Plus, the risk of becoming disabled and unable to earn an income is higher than many people think. If you are 40 years old, for example, the odds that you will suffer a long-term disability are 2.9 times higher than that you will die.<sup>1</sup>

**2 What about Social Security?** If you become totally disabled, you may be eligible. However, 50% of claims are denied. Plus, Social Security benefits are not going to provide you with a rich-and-famous lifestyle. The average monthly disability check at the start of 2000 came to just \$754.<sup>2</sup>

**3 How does DI work?** Under most disability insurance policies, benefits are paid if you become totally disabled from a covered cause. Payments continue either until you are able to return to work or the maximum benefit term is reached. Some policies pay benefits for several years; others to age 65, normal retirement time.

**4 How much coverage do I need?** You can generally purchase benefits in \$100-per-month units. The number of units you need will depend on your income and desired premium. In general, it is often recommended that you insure up to 60% of your pre-tax income. So, if you earn \$12,000 a month, you may want to obtain \$7,200 of coverage, or 72 units.

**5 Does my marital status affect my need for coverage?** That depends. Working couples who live off one salary and save the other might be able to get by. Still, whether you are married or single, it is probably more cost effective to rely on disability insurance to support yourself during a period of disability than to withdraw or borrow against accumulated assets. Most of all, unlike a total disability that can continue for an indeterminate time, disability insurance is a budgetable expense.

**6 Can I be covered by more than one policy?** Yes; however, you cannot receive benefits totaling more than a certain percentage of your income, as specified in your policies.

**7 Which is better, group or individual coverage?** Both are valuable. An individual policy can be tailored precisely to your needs. However, the cost and underwriting requirements may be higher than with a group policy. Group coverage — such as that provided either through your employer or a professional association — is often less expensive, with more liberal, group underwriting.

Many men and women, especially professionals who require higher benefit amounts, own both. They obtain as much group insurance as possible through work, then supplement it with association group or individual coverage.

**8 Does the definition of disability affect my benefits?** Yes. Some policies define disability as the inability to do “any work.” As long as you can find any employment (even outside the medical profession), you are not eligible for benefits. On the other hand, if your policy defines disability as the

inability to “perform the primary responsibilities of your profession,” you are eligible for benefits if you cannot perform your usual work as a doctor. Read your policy’s provisions carefully.

**9 Are benefits taxable?** In general, if your employer pays your premiums, benefits are taxable as income. However, if you pay premiums, benefits are income-tax-free. Talk to your tax advisor for the fine-print details.

**10 How does the waiting period work?** This is the time between the onset of a total disability and the start of benefits. Typically, waiting periods are as short as 30 days to as long as 90 or 180 days. The longer the waiting period, the lower the premium.

**When considering the purchase of disability insurance,** be sure to understand your needs, as well as your options. ■

<sup>1</sup> Donald F. Cady, *Field Guide to Estate Planning, Business Planning, & Employee Benefits* (Cincinnati: The National Underwriter Company, 2001), p. 246.

<sup>2</sup> The World Almanac and Book of Facts, 2001, p. 755.

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**No salesperson will call.**



# A new college funding option

## Section 529 Plans

**Here's something fairly new** to help you squirrel away money to pay your child's or grandchild's college bills. Sponsored by individual states, they're called Section 529 Plans, and they've only been around for a few years. Still, they've just been dramatically improved by the new tax law.

"Section 529 Plans are tax-deferred investment programs run by the states to help families save for college," Joseph F. Hurley, CPA, CEO of Savingforcollege.com, told *Your Financial Health*. Though each state's plan is different, here are some common features:

- Each program is sponsored by a state and managed by a financial institution such as a bank, mutual fund or investment management company. Each offers various investment options specifically designed for saving for college.
- Depending on the state, maximum contribution amounts range from a low of \$100,000 to as much as \$250,000 (Alaska). "Up to \$50,000 (\$100,000 jointly) may be contributed at once without gift tax (assuming no other gifts to same beneficiary within 5 years)."<sup>1</sup>
- Though there are no tax deductions for contributions, the money grows tax-deferred. However, non-qualified withdrawals are subject to a penalty.

- Through 2001, qualified withdrawals are taxable to the beneficiary. However, starting in January 2002, withdrawals made for qualified expenses (tuition, room and board, books, supplies and fees) are tax-free.
- The account is owned by the adult who creates it, not the student. However, it is generally not included in the owner's estate for estate tax purposes.
- Unlike with Education IRAs, there are no earnings restrictions. You are not penalized if you earn too much money.
- The money can be used for college or graduate school – public or private, in-state or out-of-state.
- There are no age or time limitations imposed by federal law.
- If the money is not used, it can be directed to another beneficiary or reclaimed by the donor. However, if reclaimed, there will be a 10% penalty on top of current income tax.

**For more information**, contact your state representative for specific details about the 529 Program in your state. You may also want to visit [Savingforcollege.com](http://Savingforcollege.com). ■

<sup>1</sup> Source: [Savingforcollege.com](http://Savingforcollege.com)

# Your FINANCIAL HEALTH

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## Financial Footnotes

**Twenty-four million Americans<sup>1</sup>** are in the midst of raising young (or boomerang) children and parenting their parents (or grandparents). Squeezed on both sides by the rising costs of child rearing and the financial demands of helping aging relatives, Americans are incurring debt at a rate that is 4<sup>1/2</sup> times greater than their savings rate<sup>2</sup> while reporting high levels of tension associated with time and money management.

<sup>1</sup> WNDUTV, 2/27/01

<sup>2</sup> Investing for Women, 7/30/00

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