

Money 2000

and Beyond

New law eases tax burden

This issue highlights how it pays to look into the new federal tax law. There are new tax breaks or incentives for most people — for families, students, and for saving to reach your financial goals. Some changes affect 2001 taxes. Others let you make changes this year to save money next year.

In addition to the tax rebate you received last fall, the Economic Growth and Tax Relief and Reconciliation Act of 2001 signed into law last summer contains some important provisions to cut your tax bill now and in the future. The law added incentives to help you save for retirement and higher education.

Income tax rate reductions

The new law reduces income tax rates across the board over the next 10 years. The old 15% tax bracket is now split in two:

1. A 10% bracket for the first \$6,000 of **adjusted gross income (AGI)** — from your tax form — for single filers and \$12,000 AGI for married couples filing jointly.
2. Income above that is taxed at 15% up to:
\$27,050 AGI for single filers and
\$45,200 AGI for married couples filing jointly.

Tax rate reductions

| Old rate | 2001 | 2002-03 | 2004-05 | 2006-07 |
|----------|---|---------|---------|---------|
| 39.6% | 39.1% | 38.6% | 37.6% | 35.0% |
| 36.0% | 35.5% | 35.0% | 34.0% | 33.0% |
| 31.0% | 30.5% | 30.0% | 29.0% | 28.0% |
| 28.0% | 27.5% | 27.0% | 26.0% | 25.0% |
| 15.0% | 10.0% for the first \$6,000 for singles or \$12,000 for joint filers — Income above this level up to \$27,050 for singles or \$45,200 for joint filers is taxed at 15%. | | | |

Tax credits for children and child care

The federal tax credit for dependent children goes up from \$500 in 2000 to \$600 per child in 2001 through 2004. To qualify, children must be under age 17 at the end of the tax year.

If your child tax credit exceeds your tax liability — the total taxes you pay including the amount withheld from your paychecks — **you may be entitled to a refund called an additional child credit.**

If you pay for child care, you can claim a tax credit of up to:

- \$2,400 of qualified expenses for one child or
- \$4,800 for two or more children.

The amount of this credit depends on your income. In 2003, the limit goes up to \$3,000 for one child and \$6,000 for two or more children.

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Tax tip

If you are getting a large tax refund, reduce your withholding and put more money in each paycheck. Or use that money to increase your monthly retirement plan contribution. Don't give the government a free loan!

New incentives for retirement contributions

Types of retirement plans

401(k)

Employees of for-profit corporations

403(b)

Educators, health care workers, non-profit employees

Deferred Compensation (457)

Public employees, some non-profit employees

If you are a low- or moderate-income family, the federal government may pay for part of your retirement plan.

Last year's tax law made many changes to encourage saving for retirement.

Perhaps the most significant change for many taxpayers is a tax credit — not just a deduction — for up to half of your contribution to an Individual Retirement Account (IRA) or other retirement plan.

Depending on your income, you could receive a tax credit equal to 10, 20 or 50 percent of the first \$2,000 in retirement account contributions you make each year. This includes traditional and Roth IRAs as well as employer-sponsored plans.

Higher 401(k), 403(b) and 457 plan limits

For the first time, starting in 2002 the annual contribution limits for 401(k), 403(b) and Deferred Compensation (457) plans will all be the same.

Retirement plan limits

| Year | Contribution amount | Catch-up for those over 50 |
|------|---------------------|----------------------------|
| 2002 | \$11,000 | \$1,000 |
| 2003 | \$12,000 | \$2,000 |
| 2004 | \$13,000 | \$3,000 |
| 2005 | \$14,000 | \$4,000 |
| 2006 | \$15,000 ** | \$5,000 *** |

** After 2006, contribution increases will be indexed to inflation in \$500 increments.

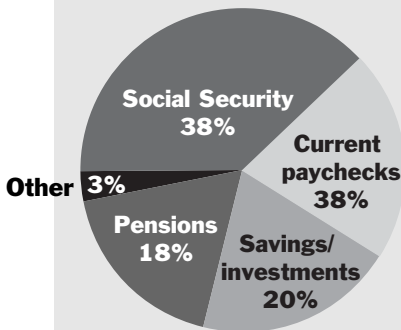
*** After 2006, catch-up contributions will also be indexed to inflation.

In addition to these increased contribution limits, the new rules make it easier for workers who change jobs to transfer retirement money from one type of plan to another. For more information, check with your plan administrator.

Tax credit for retirement plan contributions

| Single filer | Head of household | Married filing jointly | Tax credit |
|---------------------|---------------------|------------------------|------------|
| \$0 - \$15,000 | \$0 - \$22,500 | \$0 - \$30,000 | 50% |
| \$15,001 - \$16,250 | \$22,501 - \$24,375 | \$30,001 - \$32,000 | 20% |
| \$16,251 - \$25,000 | \$24,376 - \$37,500 | \$32,501 - \$50,000 | 10% |
| \$25,001 and over | \$37,501 and over | \$50,001 and over | 0% |

Sources of retirement income



IRA limits increase

After being \$2,000 for the past 20 years, starting in 2002 IRA maximum contributions increase as follows,

| Year | Amount |
|---------|---------|
| 2002-04 | \$3,000 |
| 2005-07 | \$4,000 |
| 2008 * | \$5,000 |

* After 2008, increases will be indexed to inflation in \$500 increments.

Individuals age 50 and older may add \$500 catch-up to their annual contribution for 2002 through 2005, and \$1,000 for 2006 and beyond.

Note: This information applies to your **federal** income tax. Wisconsin and several other states have not yet amended state laws to conform to the federal law. At this time, it is not known when or if this may happen. If you contribute up to the new maximum amounts, you may owe Wisconsin income tax on a portion of your tax-deferred contributions.

Tax breaks to fund education

It's now easier for parents — and grandparents — to save for their children's or grandchildren's education. Several changes to Education IRAs (now called Coverdell Education Savings Accounts or ESAs) and Section 529 Plans (Qualified State Tuition Programs) take effect in 2002. Under the new law, you contribute to both plans each year for the same child.

Education Savings Accounts (ESAs) for 2002

- Maximum annual contribution limits increased from \$500 to \$2,000.
- Contributions are not deductible, but earnings accumulate tax-free — you take the money out tax-free!
- Income limits move up from \$160,000 to \$220,000 for joint and from \$95,000 to \$110,000 for single filers.
- The contribution deadline was changed from December 31 to April 15 for the following year, same as IRAs.
- Qualified withdrawals can now be used to fund elementary, secondary or college education.

The Education Savings Account

Annual contributions: \$2,000
Annual investment return: 7%

| Age | Cumulative contributions | Tax-free earnings | Total account value |
|-----|--------------------------|-------------------|---------------------|
| 0 | \$ 2,000 | \$140 | \$ 2,140 |
| 5 | \$12,000 | \$ 3,308 | \$15,308 |
| 10 | \$22,000 | \$11,777 | \$33,777 |
| 15 | \$32,000 | \$27,680 | \$59,680 |
| 18 | \$36,000 | \$36,758 | \$72,758 |

Section 529 Plans

These state-sponsored plans allow you to take advantage of state tax benefits as well as federal benefits.

- Starting this year **distributions** — money you withdraw from the plan to pay for college — are tax-free to the

extent that they are used for qualified higher education expenses. Until now, distributions were taxed at the student's rate.

- It's now easier to transfer funds from one education savings plan to another. For example, you can transfer funds from a prepaid tuition plan to another education savings plan administered by the same state

Tax benefits for students

If you paid interest on a qualified student loan, you may be able to deduct up to \$2,500 on your 2001 tax return, up from \$2,000 in 2000. For 2001 taxes, the phase-out limits are:

- \$40,000-\$55,000 AGI for single filers or
- \$60,000-\$75,000 AGI for married couples filing jointly.

In 2002, these limits increase to \$50,000-\$65,000 for singles and \$100,000-\$130,000 for joint filers. Also in 2002, the 60-month limit for this student loan interest deduction is repealed.

Starting in 2002, there is a \$3,000 deduction for college tuition and related fees for single filers with up to \$65,000 AGI, and for joint filers with up to \$130,000 AGI.

If you paid qualified higher education expenses for you, your spouse or a dependent, you may be able to claim either a Hope or Lifelong Learning tax credit.

Hope credits of up to \$1,500 per student cover qualified expenses during the first two years of college or post-secondary education.

Lifelong Learning credits may be claimed for coursework in a post-secondary degree program or classes to acquire or improve job skills, up to \$1,000 a year, subject to income phase-outs.



EdVest — Wisconsin's Section 529 Plan

You can receive a tax deduction of up to \$3,000 per child on your Wisconsin income tax return for contributions to EdVest accounts. There are no income limits for this deduction, and the funds can be used for public and private schools nationwide. Contributions can be as low as \$25 a month or as high as \$246,000 a year per account. For more information, visit the EdVest Web site:

www.edvest.com



Do you qualify for Earned Income Credit?

Earned Income Credit (EIC) is a refundable federal and state tax credit for eligible individuals and families who work and have earned income under \$32,121. EIC reduces the amount of tax you owe, and may give you a refund — even if you don't owe any tax.

To claim the EIC on your 2001 tax return, you must meet all of the following rules:

1. You must have earned income during 2001.
2. Your earned income and modified AGI (from your tax form) must each be less than:
\$32,121 if you have more than one qualifying child, or
\$28,281 if you have one qualifying child, or
\$10,710 if you are 25 to 64 and have no qualifying children (federal credit only).
3. Your investment income must be less than \$2,400.
4. Your filing status can be any filing status **except** married filing a separate return.
5. You, or your spouse if filing jointly, cannot be a qualifying child of another person.
6. Your qualifying child cannot be the qualifying child of another person whose modified AGI is more than yours.

A qualifying child is a child who:

- Is your son, daughter, adopted child, grandchild, great-grandchild, stepchild, or eligible foster child, and

- Was under age 19 or under age 24 and a full-time student at the end of the tax year, or permanently and totally disabled at any age during the year and
- Lived with you in the United States for more than half of the tax year, or for all of the tax year if the child is your eligible foster child.

To receive the federal credit, complete Schedule EIC with Form 1040 or 1040A (childless workers only use with 1040EZ) and file these with the Internal Revenue Service (IRS).

To receive the Wisconsin credit, complete the EIC-W Form with Form 1 or 1A and file these with the Wisconsin Department of Revenue.

For more information

Call the IRS toll-free: (800) 829-1040
(800) 829-4059 TTY

Request a free copy of IRS publications 17 *Your Federal Income Tax* and 596 *Earned Income Credit* from IRS Forms & Publications: (800) 829-3676 — Allow two weeks.

Some libraries offer tax help through April 15. Or contact the regional Wisconsin Department of Revenue (listed in the government pages of your phone book).

Visit these Web sites:

www.irs.gov

www.dor.state.wi.us

www.uwex.edu/ces/econ

Money 2000 and Beyond:

www.uwex.edu/ces/money2000

Internet access is available at many public libraries or other public places in your community.

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