Friends of Algeria

Algerian-American Association of Greater Washington
P.O. Box 65063
Washington, DC 20035

Email: foa@aaagw.org
Web: www.aaagw.org

Supplement

Algerian-American Association of Greater Washington

Friends of Algeria

2001 Tax Legislation – Tax Relief for Everyone

By Aziz Benbrahim

The purpose of this article is to inform you of some key provisions of the 2001 tax legislation that congress passed last May and the President signed in June of the same year involving across-the-board tax cut from which every body can benefit. It was the largest tax cut since 1981, a $1.35 trillion tax relief over the next 10 years that effects nearly very taxpayer in more ways than one. The issue of who benefits the most from this tax "relief" is a question that's beyond the scope of this article and I will leave it up to the readers to form an opinion. My goal is to provide the reader with information regarding the recent tax legislation development that everyone can find it useful.

The 2001 tax package offers many new opportunities for tax planning that no one can afford to overlook it.

New Income Tax Rates: The principal element of the new tax law is the reduction of the marginal tax rates for individuals, introducing for the first time since 1986 that ordinary income tax rates will drop. Most taxpayers benefit under these rate cuts, which start with a new 10% tax bracket carved out for the lower portion of the existing 15% bracket. This is the reduction that resulted in most taxpayers receiving advance check refund in 2001. Congress also slashed all other individual tax rates, except the 15% bracket, for 2001 effectively by 0.5% across the board. Those cuts, however, did not result in advance refunds. The retroactive rate cuts for 2001 — from the across-the-board benefit of the new 10% rate to the reduced 27.5% (from 28%), 30.5% (from 31%), 35.5 % (from 36%) and 39.1% (from 39.6%) effective tax rates for 2001 — amount to small saving for some taxpayers compared to the benefits they will receive from the rate cuts to come over the next five years.

Through 2007, the new 10% bracket will apply to $12,000 on joint returns, $10,000 on head of household returns and $6,000 on the returns for single filers. After 2007, these amounts will be adjusted annually for inflation, as will the amounts for the other tax brackets.

Marriage Penalty Relief, Education Savings and Child Care: In addition to the basic income tax rate cuts, the 2001 tax legislation includes changes in joint-filer benefits and tax cuts for education savings and child care. As a result of the changes, the complexities of a taxpayer's tax obligations will continue to increase.

1. Marriage Penalty Relief: When this relief arrives, it will provide joint filers with a standard deduction twice that for single filers, phase in over a four year period starting in 2005 and ending in 2008. Relief will also come in the form of an expanded 15% bracket equal to twice that of single taxpayers over the 2006 to 2008 period. Although the expanded 15% tax rate will benefit all couples, those usually itemized (schedule A users) instead of taking the standard deductions should not expect marriage penalty relief to bring a substantial reduction in their tax bill.
2. Education incentives: The new tax law greatly expands the role education IRAs can play in future family savings strategies as a result of a significant increase in contribution limits, starting in 2002, to $2,000. Also starting in 2002, contributions will be allowable not only from individuals but also from corporations, tax-exempt organizations and other entities. Taxpayers can now make contributions until April 15 of the following year, rather than the current

December 31 cutoff. The legislation also has expanded the base of those who may contribute to an education IRA. The contribution phase-out range for joint-filers jumps to double that of single filers and is $190,000 to $220,000. Education IRAs now are available to pay for elementary and secondary school tuition – public and private – as well as the cost of higher education. Some taxpayers also stand to benefit from other education provisions in the new tax law, including college tuition deduction. People facing college education expenses will need to plan carefully to obtain maximum benefits from these incentives due to different eligibility requirements, income phase-outs and other qualifications (too many to list here – this is just to make you aware of the existence of the incentives).

3. Child tax Credits: The new tax law doubles the current child tax credit to $1,000, phase in over 10 years, starting in 2001 when the credit increases from $500 to $600.

Estate Taxes: The new legislation gradually increases the estate tax "exemption" from $1 million to $3.5 million through 2009 and then repeals the estate tax for just one year in 2010. This means that the new law allows the current estate rules, rates and exemption to come back in effect again in year 2011. I will not add much to this issue since it is a complex area and I would recommend that anyone interested to do some complex tax planning to consult with a CPA or an Attorney.

Retirement Savings and Pension Reform: Retirement savings incentives and pension plan reform make up a significant portion of the new legislation. The increases in contribution limits and tax-favored savings options will likely leave many taxpayers confused by the choices and should carefully study their options to make intelligent decisions. Among the more popular changes the new tax law makes to qualified plan and contribution limits are the following:

1. IRA Contributions: For both Traditional and Roth IRAs, the limit on contributions will rise from the current $2,000 in 2001 annual cap to $5,000 ($3,000 for 2002 to 2004, $4,000 for 2005 to 2007 and $5,000 for 2008 and thereafter) with annual adjustments for inflation after 2008.
2. "Catch-up" Contributions: People age 50 and older will be permitted to make "catch-up" contribution to IRAs, 401(k) plans and other salary-reduction arrangements. They can contribute an additional $500 each year from 2002 to 2005 and $1,000 more in 2006 and all years thereafter. These catch-up payments either can be deductible or made to a Roth IRA if the taxpayer meets the "Adjusted Gross Income" (AGI) limits for regular contributions for the year.
3. 401(k) Contribution Limits: The limit on salary-reduction contributions to 401(k)-type plans will rise from $10,500 in 2001 to $15,000 by 2006.. Special catch-up contributions also apply.
4. Contributions Tax Credit: Lower-income workers will be entitled to a tax credit, instead of just deduction for contributions to retirement savings.

Final Note: Due to recent budgetary constraints, do not be surprised if some of the new provisions are cancelled or modified. While the new tax legislation significantly overhauls the existing system, it is by no means that simple. As a result, I recommend that everyone takes some time to understand (or consult with a CPA) the new legislation's deductions, credits, estate tax and pension reform aspects, and their timing. This will help you make the best plan for your future financial situation and minimize your tax obligations.

Tax Seminar

March 17, 2002 at 2:00 p.m.

At the Bethesda-Chevy Chase Services Center.

Dr. **Mustapha Rechache**, CPA, MBA, Ph.D, will make a general presentation on federal and state income tax filing as well as tips and advice on how to avoid common mistakes.

Standard tax return forms will be available for federal, MD, VA, and DC.

Dr Rechache has also offered to assist low-income members of the community in filing their taxes. If interested in this free service, please contact Dr. Rechache directly for a free filing and/or advices (301-515-7066).