

LEGEND FINANCIAL ADVISORS, INC.
SUMMARY OF THE
ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001

Legend Financial Advisors, Inc.
5700 Corporate Drive, Suite 350
Pittsburgh, PA 15237
Phone: (412) 635-9210
Toll Free: (888) 236-5960
Fax: (412) 635-9213
E-mail: legend@legend-financial.com
Web Site: www.legend-financial.com

OVERVIEW

On May 26, 2001 Congress passed the Economic Growth and Tax Relief Reconciliation Act of 2001 – the largest tax cut since 1981. President Bush signed it into law on June 7, 2001. This Act is a patchwork of many complicated provisions that phase in and out over the next ten years. Some of the highlights include:

- Reduction in income tax rates
- Partial elimination of the marriage penalty
- Reduction in estate and generation-skipping transfer taxes and full repeal of both in 2010; elimination of basis step-up rules in 2010, with certain exceptions
- Retention of the gift tax
- Increase in contribution limits for retirement plans
- Increase in the child tax credit
- Additional flexibility for education IRAs and qualified-tuition programs also known as Section 529 plans

The Act is subject to a sunset provision, which provides that unless Congress votes to reauthorize this legislation, it will expire on December 31, 2010 and pre-Act law will then go into effect. The following is a description of some of the provisions of the Act that may be relevant for you.

INCOME TAX

New 10% Bracket Created:

A new 10% rate will apply to taxable income that was formerly taxed at 15%. This new rate will apply retroactively to January 1, 2001. A credit in the form of a tax refund will be issued in 2001 to carry out the effect of the new 10% bracket. The maximum credit will be \$300 for a single individual, \$500 for a head of household and \$600 for a married couple filing a joint return. The Department of the Treasury plans to issue these checks no later than September 30, 2001.

Individual Income Tax Rates:

Effective July, 2001, the current income tax rates are phased down over the next six years according to the following schedule. The reduction for 2001 will be reflected in revised withholding tables to be issued by the Treasury Department as quickly as possible.

CALENDAR YEAR	28% RATE DECREASED TO:	31% RATE DECREASED TO:	36% RATE DECREASED TO:	39.6% RATE DECREASED TO:
As of July 1, 2001	27.5%	30.5%	35.5%	39.1%
2002-2003	27%	30%	35%	38.8%
2004-2005	26%	29%	34%	37.6%
2006 and later	25%	28%	33%	35%

Itemized Deductions:

The phaseout of itemized deductions is being repealed. In 2006 and 2007, the phaseout will be two-thirds of the current phaseout and in 2008 and 2009 it will be one-third of the current phaseout. The phaseout is completely eliminated for taxable years after 2009.

Personal Exemptions:

The phaseout of personal exemptions is also being repealed. In 2006 and 2007, the phaseout will be two-thirds of the current phaseout and in 2008 and 2009 it will be one-third of the current phaseout. The phaseout is completely eliminated for taxable years after 2009.

Taxpayers Subject To The Alternative Minimum Tax

For taxable years 2001-2004, the alternative minimum tax exemption amount is increased by \$2,000 for single taxpayers and by \$4,000 for married taxpayers filing joint returns. The increase in the exemption amount is not effective for taxable years after 2004.

Income Tax – Implications and Strategies:

- Since income tax rates are decreasing over the next several years, it may be advisable to defer ordinary income to a later year when possible (e.g. deferring bonuses or exercise of stock options).
- There is a projected doubling of the number of taxpayers who will be subject to the alternative minimum tax under the Act. Therefore, income tax savings due to the tax rate reductions will be decreased.
- Tax-exempt investments, such as municipal bonds, may be less attractive when ordinary income tax rates are lower.
- Although the phaseout of the limitation on itemized deductions will mean that taxpayers will be able to deduct more of their charitable contributions starting in 2006, the lower tax rates that are in effect at that point may reduce the overall benefit of the phaseout. Taxpayers who are considering a large charitable contribution should evaluate how the timing of the contribution will affect their tax benefit.
- The reduction in the alternative minimum tax in 2001-2004 means that exercising qualified stock options in those years may be more beneficial than exercising in later years. This strategy, as with alternative minimum tax planning generally, needs to be coordinated in the overall income tax plan to reap optimal benefits.

Marriage Penalty Relief:

Standard Deduction:

Currently, the basic standard deduction for a married couple is \$7,600 compared to \$4,550 for an unmarried individual, resulting in a "marriage penalty." Beginning in 2005, the basic standard deduction for a married couple filing a joint return will be increased in steps until it equals twice the basic standard deduction for an unmarried individual. The increases will occur according to the following schedule:

CALENDAR YEAR	PERCENTAGE OF SINGLE TAXPAYER'S STANDARD DEDUCTION
2005	174%
2006	184%
2007	187%
2008	190%
2009 and later	200%

Elimination of Penalty in 10% and 15% Bracket:

The marriage penalty is also reflected in the current income tax brackets. The newly created 10% bracket sets in income levels for married couples at twice the amount for single individuals. In addition, the current 15% income tax bracket for a married couple will be increased to twice the size of the 15% income tax bracket for an unmarried individual. The marriage penalty is not eliminated in the four highest rate brackets. The change to the 15% bracket is phased in over four years beginning in 2005, as follows:

CALENDAR YEAR	PERCENTAGE OF SINGLE TAXPAYER'S TOP BRACKET
2005	180%
2006	187%
2007	193%
2008	200%

RETIREMENT PLANS

Increases in Contribution Limits:

An individual's total deductible and nondeductible contributions to various types of retirement plans have been increased as follows:

Calendar Year	Type of Plan			Overall Defined Contribution Plan Limits
	Traditional IRA and Roth IRA	401(k), 403(b), 457 and SEP	SIMPLE	
2002	\$3,000	\$11,000	\$7,000	\$40,000
2003	\$3,000	\$12,000	\$8,000	AFI
2004	\$3,000	\$13,000	\$9,000	AFI
2005	\$4,000	\$14,000	\$10,000	AFI
2006	\$4,000	\$15,000	AFI	AFI
2007	\$4,000	AFI	AFI	AFI
2008	\$5,000	AFI	AFI	AFI
2009+	AFI	AFI	AFI	AFI

AFI = Adjustment For Inflation

“Catch-Up” Provisions:

Individuals who are at least 50 years of age will be permitted to make additional contributions to employer-sponsored retirement plans and traditional IRAs. The normal maximum contribution limit for traditional IRAs described in the chart above is increased by \$500 for 2002-2005 and by \$1,000 for 2006. The normal limit for 401(k), 403(b) and 457 plans is increased by \$1,000 in 2002, and by \$1,000 annually until it reaches \$15,000 in 2006. Thereafter, the additional contribution limits will be indexed for inflation.

Roth IRA: The age 50 or older catch-up contributions allowed in 2002 and after are not subject to the tax law's contribution limits or nondiscrimination rules.

Increased Rollover Opportunities:

Eligible rollover distributions from qualified retirement plans, section 403(b) annuities and governmental section 457 plans may be rolled over to any other of these plans, although these plans will not be required to accept rollovers. Employee after-tax contributions may be rolled over into another qualified plan or a traditional IRA. The ability of a surviving spouse to rollover a retirement plan is extended to qualified retirement plans, section 403(b) annuities and governmental section 457 plans. These provisions are effective for distributions made after December 31, 2001.

“Roth” Contributions to 401(k) and 403(b) Plans:

Starting in 2006, 401(k) plans and 403(b) annuity plans may include a contribution program similar to a Roth IRA. This program would allow employees to designate all or a portion of their elective deferrals as Roth Contributions that will be taxed currently, in exchange for tax-free distributions (if certain conditions are met). Plans will be required to maintain separate accounts for these contributions. Distributions from these accounts may only be rolled over to another Roth contribution account or a Roth IRA.

Miscellaneous Retirement Plan Changes:

Starting in 2002, employer matching contributions are required to be fully vested after an employee's third year of service or in increments of 20% for each year beginning with an employee's second year of service, with an employee vesting in full after six (6) years of service.

Also starting in 2002, the annual limitation on deductible contributions to a profit-sharing or stock bonus plan is increased from 15% to 25% of the employee's compensation for those covered by a plan during the year of contribution.

Annual additions to a participant's profit-sharing or 401(k) plan account – including employee and employer contributions – may be as high as \$40,000 (or 100% of compensation, if less) starting in 2002, up from \$35,000/25% of compensation in 2001.

A benefit of as much as \$160,000 (or 100% of average compensation, if less) may be provided for a participant in a defined benefit pension plan for years ending after December 31, 2001, up from \$140,000/100% of compensation.

Beginning in 2002, retirement plans may take as much as \$200,000 of a participant's compensation into account when applying these limits, up from \$170,000.

An employer's tax deduction limit for contributions to profit-sharing and stock bonus plans increases from 15% to 25% of the total compensation of covered employees beginning in 2002.

As early as 2003, employers also will have the ability to add a “deemed IRA” feature to a tax-qualified 401(k), profit sharing, or money purchase pension plan; a 403(b) tax-sheltered annuity arrangement; or a 457 plan. This feature would allow employees to make voluntary contributions to a separate plan account or annuity that meets the requirement of a traditional or Roth IRA.

Retirement Plans – Implications and Strategies:

- Taxpayers who are already contributing the maximum amount to their retirement plans should consider increasing their contributions in line with the new limits.
- Taxpayers who are over age 50 may wish to take advantage of the new “catch-up” provisions.
- Taxpayers with multiple retirement plans should determine whether a rollover would be advisable.

BENEFITS FOR TAXPAYERS WITH CHILDREN

Child Tax Credit:

The current child tax credit of \$500 per child will be increased to \$1,000 per child by 2010. The credit will be increased according to the following schedule:

CALENDAR YEAR	CREDIT AMOUNT (PER CHILD)
2001-2004	\$600
2005-2008	\$700
2009	\$800
2010	\$1,000

The credit will now be refundable to the extent of 10% of income in excess of \$10,000 for calendar years 2001-2004 and 15% of income in excess of \$10,000 for calendar years 2005 and later. Beginning in 2002, the \$10,000 amount will be indexed for inflation. The credit continues to phase out for taxpayers whose adjusted gross income exceeds \$75,000 for single filers, \$110,000 for joint filers and \$55,000 for married couples filing separately.

Adoption Tax Credit:

The adoption tax credit will be increased from \$5,000 to \$10,000 as of January 1, 2002 for non-special needs adoptions and will be indexed for inflation. For children other than special needs children, the credit is available for qualified adoption expenses. For special needs children, the credit is provided even if the taxpayer has not incurred any qualified adoption expenses. The credit is phased out for taxpayers with \$150,000 to \$190,000 of modified adjusted gross income, an increase from the prior phaseout limits of \$75,000 to \$115,000 of income. Instead of the credit, taxpayers may exclude up to \$10,000 paid by an employer pursuant to an adoption assistance program from their income. Income phaseouts for the exclusion are the same as for the credit.

EDUCATION

Education IRAs:

Starting January 1, 2002, the limit on contributions to an Education IRA is increased from \$500 per year to \$2,000 per year for each beneficiary under age 18. Contributions for any taxable year may be made until April 15th of the following year. Additionally, the phaseout for married couples will be increased to incomes between \$190,000 and \$220,000 (i.e., twice the range for single taxpayers). Corporations and other entities may make contributions to education IRAs regardless of income.

Qualified Education Expenses:

For purposes of Education IRAs, the definition of qualified education expense is no longer limited to undergraduate and graduate school expenses. The definition now includes elementary and secondary school expenses, such as tuition, fees, books, uniforms, extended-day programs and the purchase of computer technology or equipment.

Qualified Tuition Programs:

Qualified state tuition programs have been renamed "qualified tuition programs," and the definition has been expanded to include prepaid tuition programs maintained by educational institutions in addition to state-sponsored plans. These plans can now be used to pay for expenses of a special needs beneficiary that are necessary for enrollment in an eligible educational institution. Finally, for distributions made after January 1, 2004, the current requirement that plans impose a penalty on non-education related distributions is eliminated. Instead, these distributions will be subject to an additional tax equal to 10% of the distribution.

Tax-Free Distributions from Qualified Tuition Programs:

Effective January 1, 2002, amounts distributed from a qualified tuition program will not be subject to tax, even at the beneficiary's rate, as long as the distribution is used for qualified higher education expense.

Credits and Exclusions Are No Longer Mutually Exclusive:

Taxpayers can now claim a HOPE credit or Lifetime Learning Credit for a taxable year and exclude from income amounts distributed from education IRAs or qualified tuition programs.

Other education tax breaks:

Tuition credits or other amounts may be transferred tax-free from one qualified tuition program to another qualified tuition program for the same beneficiary.

An account owner can now transfer a Section 529 plan to a first cousin or someone outside of the immediate family of the original beneficiary.

The income phase-out for the student loan interest deduction is increased to \$50,000-\$65,000 for single and to \$100,000-\$150,000 for married taxpayers. This phase-out will be indexed after 2000. The student interest deduction is no longer subject to a limit on the number of months interest is deductible.

Dependent Care Tax Credit:

The dependent care tax credit rate has been raised from 30 to 35 percent; the amount of eligible employment-related expenses has been raised from \$2,400 to \$3,000 (from \$4,800 to \$6,000 for more than one qualifying individual). Also, the beginning point of phase-out income is increased to \$15,000 of adjusted gross income, starting in 2002.

Credit for employer-provided child care facilities:

Employers will be allowed a credit equal to 25% of qualified expenses for employee child care and 10% of qualified expense for child care resource and referral services, to a maximum \$150,000 per year credit beginning after 2001.

Earned Income Tax Credit:

The bill includes provisions to:

- Increase the income phaseout range for married couples filing joint returns by \$3,000, phased in over seven years, beginning in 2002.
- Exclude non-taxable employee compensation from the definition of earned income (effective in 2002).
- Expand the definition of qualifying child (effective in 2002).
- Allow IRS to use the math error procedure to deny the EITC if the Federal Case Registry database indicates the taxpayer is the non-custodial parent (effective in 2004).

ESTATE, GIFT, AND GENERATION-SKIPPING TAXES

Repeal of Estate Tax:

The estate tax will be repealed over a 10-year period. The exemption amount will be increased and the highest tax rates will be lowered, according to the following schedule. For deaths occurring in 2002, this rate reduction operates to tax estates in excess of \$2.5 million at the top 50% rate. The Treasury Department will issue a new table for subsequent years.

CALENDAR YEAR	EXEMPTION AMOUNT FOR TRANSFERS AT DEATH ONLY	HIGHEST ESTATE AND GIFT TAX RATE
2002	\$1 million	50%
2003	\$1 million	49%
2004	\$1.5 million	48%
2005	\$1.5 million	47%
2006	\$2 million	46%
2007	\$2 million	45%
2008	\$2 million	45%
2009	\$3.5 million	45%
2010	Estate Tax Repealed	Estate Tax Repealed

Repeal of Generation-Skipping Transfer Tax:

Until 2004, the rules regarding the Generation-Skipping Tax exemption amount will not change. The exemption amount is currently \$1,060,000, indexed for inflation. The exemption will continue to be indexed for inflation in 2002 and 2003. Beginning in 2004, the Generation-Skipping exemption amount will equal the exemption amount for transfers at death (see above). From 2002-2009, the Generation-Skipping Tax rate will equal the top estate tax rate. As of 2010, the Generation-Skipping Tax is completely repealed.

Gift Tax Rates and Exemption:

The top gift tax rate will be reduced according to the same schedule as the top estate tax rate. Beginning in 2010, the top gift tax rate will be reduced to the top individual income tax rate (35% in 2010). Furthermore, the lifetime gift tax exemption is increased to \$1 million as of January 1, 2002 and stays at that level indefinitely. This amount is not indexed for inflation.

Other Estate Law Changes:

Certain estate assets – amounts in tax-deferred retirement plans and IRAs that will be taxable upon distribution, for example – will not be eligible for the basis step-ups. These assets, along with any others that aren't allocated a basis step-up, will pass to heirs and beneficiaries with a carryover basis equal to the lesser of (1) the decedent's adjusted basis in the property or (2) the property's fair market value on the date of death.

Income tax exclusion for up to \$250,000 of gain on sale of principal residence is extended to decedent's estate, starting in 2010.

Special deduction for qualified family-owned business interest is repealed, effective for estates of decedents dying after 2003.

New Generation-Skipping Tax Rules:

Retroactive to January 1, 2001, several new provisions come into effect, which will make it easier for taxpayers to use their Generation-Skipping Tax exemption before this tax is repealed. The changes include the following:

- The generation-skipping transfer tax exemption will automatically be allocated to lifetime transfers to Generation-Skipping Tax trusts that are not direct skips (i.e., most Generation-Skipping Tax trusts), unless the taxpayer elects not to apply the exemption;
- Taxpayers will now be allowed to make retroactive allocations of their Generation-Skipping Tax tax exemption to trusts benefiting future generations if a non-skip person (generally, a child) predeceases the person making the gift (generally, the parent);
- The new legislation also provides for a “qualified severance” of a trust into Generation-Skipping Tax exempt and non-exempt portions at the discretion of the trustee;
- A late Generation-Skipping Tax allocation will be permitted to be made based on the gift tax value at the time of the transfer (rather than the value on the date of filing the gift tax return) as long as the taxpayer demonstrates substantial compliance with allocation rules.

New Step-Up in Cost Basis Rules:

After the repeal of the estate tax, the current rule that property acquired from a decedent receives a step-up in basis will no longer apply. Instead, recipients of property transferred at death will receive a basis equal to the lesser of the decedent's basis or the fair market value of the property at the date of death. The executor of an estate will be able to allocate an aggregate basis increase of \$1.3 million, adjusted for any of the decedent's unused built-in losses and loss carryover. This basis increase is adjusted to \$60,000 in the case of estates of decedents who were not residents or citizens of the United States. An additional \$3 million basis increase will be permitted for property that passes to a surviving spouse, either outright or in the form of a qualified terminable interest (QTIP). After 2010, these amounts will be subject to a cost of living adjustment. No basis increase will be permitted for property that is acquired by the decedent within three years of death, unless it was acquired from a spouse or for full and adequate consideration. Rules regarding the ownership of jointly held property remain the same and basis can be allocated to the decedent's ownership percentage under the new law. Community property is treated as owned fully by the decedent for this purpose provided that the decedent actually owned at least 50% of such property.

Filing Requirement:

After the estate tax is repealed, information returns will need to be filed for any estate with a value that either exceeds the amount of the basis increase amount (\$1.3 million in 2010), or includes appreciated property acquired by the decedent within three years of death.

State Death Tax Credit:

For taxable years 2002-2004, the state death tax credit will be reduced, after which it will be replaced by an estate tax deduction for state death taxes that are actually paid. This change will be implemented as follows:

CALENDAR YEAR	REDUCTION FROM CURRENT CREDIT AMOUNT
2002	25%
2003	50%
2004	75%
2005	Credit is Repealed and Replaced with Deduction

Estate, Gift and Generation-Skipping Taxes – Implementation and Strategies:

- Estate plans should be updated to reflect changes in the exemption amount and potential repeal of the estate tax. Many current plans allocate the entire exemption amount to a family trust, which could disinherit a surviving spouse.
- Estate plans should also contain provisions that address the new carryover basis rules in the event of death in 2010 or later. The plan should be drafted to take maximum advantage of the \$1.3 million basis increase. It may also be advisable to add instructions for executors regarding how the value of the basis increases should be allocated, as the basis increase allocation will affect the heirs' inheritance.
- In order to make it easier for executors to prove the basis of property in an estate, the taxpayers should keep track of basis, including items such as capital improvements to real estate.
- Gifting programs should be reviewed in light of the increase in the gift tax exemption in 2002.
- Married couples should ensure that their assets are properly balanced so that they can each take maximum advantage of the increasing estate tax exemption and Generation-Skipping Tax exemption amounts.
- Generation-Skipping Tax allocations, not always made to life insurance trusts that will likely benefit only children, can now be made in the event a child predeceases his or her children and the trust benefits the grandchildren.
- Revenues in the thirty-five (35) states that impose an estate tax that is only equal to the federal credit for state death taxes paid will be significantly impacted according to studies of this issue. States may need to address this issue in terms of other tax increases or reductions in services.

SUNSET PROVISION:

All of the new provisions described above will not apply after December 31, 2010 unless they are reauthorized by Congress. If they are not reauthorized, pre-Act law will take effect on January 1, 2011.