A Reprint from *Tierra Grande*, the Real Estate Center Journal

NEW LAW REDUCES TAXES

By Jerrold J. Stern

The Economic Growth and Tax Relief Reconciliation Act of 2001 became law in June. During the next ten years it lowers income tax rates, phases out the estate tax and raises IRA contribution limits. Virtually all taxpayers will benefit, including real estate professionals and investors.

Tax rates decline. The table shows income tax rate reductions. For 2001, all tax rates higher than 15 percent are reduced by one-half of a percentage point. Also during 2001, the federal government is sending special "advance payment" refund checks to taxpayers in lieu of reducing the 15 percent tax bracket rate. Single taxpayers received as much as a $300 refund, and married taxpayers filing joint tax returns received as much as $600.

Starting in 2002, a new 10 percent tax bracket will replace part of the 15 percent tax bracket. By 2006, the top tax rate will fall from 39.6 percent to 35 percent. The other three tax rates that are more than 15 percent will each decline 3 percentage points by 2006.

Many taxpayers will benefit from an increase in the child tax credit, which will be $600 per dependent child from 2001–2004, a $100 increase. After 2004, the credit will rise until it reaches $1,000 per dependent child in 2010. Dependent children must be age 17 or younger for the credit to apply. The credit phases out for high-income taxpayers starting at $75,000 adjusted gross income for singles and $110,000 for married taxpayers filing jointly.

Other tax reductions are scheduled to begin in later years. The "marriage tax," a hidden tax affecting married couples, will gradually be reduced starting in 2005. The law in effect now limits itemized deductions and personal exemptions as taxpayers reach higher income levels. Starting in 2006, the new law will gradually reduce these limits, allowing more in deductions. By 2010, high-income taxpayers will be able to use all of their deductions and exemptions.

Estate tax phases out. The act provides for a reduction followed by an elimination of the estate tax, a relevant issue for the real estate industry, as properties would no longer be taxed as they pass from one generation to the next. The heirs would instead assume the basis of the deceased taxpayer.

The phaseout begins in 2002. Top estate and gift tax rates slowly drop from 55 percent to 45 percent by 2007. The minimum size of an estate subject to the estate tax rises from $675,000 to $1 million in 2002. The gift tax is not phased out entirely, as the estate tax is in 2010.

The new law contains an unusual "sunset provision." If Congress takes no further action, the estate, gift, and generation-skipping transfer rules in effect prior to the act will become law once again on January 1, 2011. Specific features of the estate tax phaseout will be discussed in an upcoming *Tierra Grande*.

IRA limits rise. The $2,000 limit for contributions to Roth and deductible IRAs will rise to $3,000 from 2002 to 2004. After 2004, the limit will continue to increase, reaching $5,000 by 2008. Starting in 2009, it will rise annually based on inflation. Individuals age 50 and older are permitted to make additional annual IRA contributions of $500

YEAR	TAX RATES [in percent]					
2000	15		28	31	36	39.6
2001	15		27.5	30.5	35.5	39.1
2002–2003	10	15	27	30	35	38.6
2004–2005	10	15	26	29	34	37.6
2006–2010	10	15	25	28	33	35

Adapted from Grant Thornton, "Significant Provisions of the 2001 Tax Relief Act," www.grantthornton.com/content/13758.asp

from 2002 to 2005 and $1,000 in 2006 and thereafter.

Educational IRA limits are raised to $2,000 per child per year starting in 2002, up from $500. Contributions will no longer be deductible, but earnings will accumulate tax-free. The adjusted gross income phaseout range for joint filers increases from $150,000–$160,000 to $190,000–$220,000. The range for single filers is one-half that of joint filers. Other educational benefits provided by the new law include a deduction for qualified higher education expenses and an expansion of qualified tuition programs that can be offered by states.

The Economic Growth and Tax Relief Reconciliation Act of 2001 contains a number of complexities. Consultation with an accountant, attorney or real estate professional is recommended.

Dr. Stern (stern@indiana.edu) is a research fellow with the Real Estate Center at Texas A&M University and a professor of accounting in the Kelley School of Business at Indiana University.

LOWRY MAYS COLLEGE & GRADUATE SCHOOL OF BUSINESS

Texas A&M University
2115 TAMU
College Station, TX 77843-2115

http://recenter.tamu.edu
979-845-2031
800-244-2144 orders only

Tierra Grande (ISSN 1070-0234), formerly *Real Estate Center Journal*, is published quarterly by the Real Estate Center at Texas A&M University, College Station, Texas 77843-2115. Subscriptions are free to Texas real estate licensees. Other subscribers, $20 per year.