

The Sgroi Financial

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Summer 2001 Newsletter

Planning for Today and Tomorrow

Our New “Tax “ Law

On June 6th 2001, President Bush signed the Economic Growth and Tax Relief Reconciliation Act of 2001 into law. This is the income tax legislation that was such a major focus of his campaign. As far as tax cuts go, it's not a very big deal. But as far as investment for education and retirement, the two major reasons people do invest, it is an enormous change for the better. This article will deal with those changes as opposed to the income tax rate changes and the “Advanced Refunds” that will be issued in the next few months.

One very important concept to keep in mind is the difference between tax deferred earnings and tax free earnings. When an investment plan grows tax deferred, it means that the earnings and growth which accumulate in the plan will be taxed when they are withdrawn. Examples of this include; 401(k) plans, 403(b) plans and traditional IRAs. With most of these plans, the contributions are also tax deductible. So your investment goes in without being taxed and grows within the plan without being taxed, but they are taxed as regular income when they come out. On the other hand, with a plan that accumulates earnings tax free, like a Roth IRA, no taxes are due at any time. Money going into the plan has already been taxed. In other words, contributions are not tax deductible but they grow tax free and the withdrawals are not taxed either. A combination of these two types of plans can make for some very powerful financial planning and both are effected by the new legislation.

IRA Contribution Amounts Increased. First and foremost, IRA contribution limits are being increased. Starting next year, the limit will increase to \$3,000. In 2005 it goes to \$4,000 and then up to \$5,000 in 2008. From that point forward it will increase by \$500 increments based on inflation. These limits apply to both traditional and Roth IRAs.

IRA Catch - Up. For folks fifty and older, there is a new IRA “Catch-Up” provision that allows an additional contribution of \$500 per year during years 2002 through 2005. So by 2005 their limit will have jumped to \$5,000 and by 2008 a person over fifty can contribute up to \$6,000 per year into their traditional or Roth IRA. This is absolutely awesome!!

401(k) and 403(b) Contributions Increased.

Currently the maximum amount that can be contributed to these plans is, for most people, \$10,500 per year. Starting next year the limits will be increased as follows:

\$11,000 in 2002
\$12,000 in 2003
\$13,000 in 2004
\$14,000 in 2005
\$15,000 in 2006

From 2006 on increases will be made in \$500 increments based on the rate of inflation.

457 Deferred Compensation Improvements

457 Plans are tax deferred retirement savings plans offered to state and local government employees. (Remember, all these different numbers, like 401(k), 403(b), 457, etc. refer to the section of the tax law that deals with that particular plan). The contribution amounts will be increased to the same amounts as 401(k) or 403(b). In addition, when an employee separates from service, 457 Plans may be rolled over into an IRA, just like other types of plans. This is a major improvement, as the restrictions on 457 were extremely tight and often detrimental to the employee, whereas the advantages of rolling into an IRA can be immense.

Catch - Up for 401(k), 403(b) and 457.

Starting in 2002, employees age fifty or older may contribute an additional amount into the above named plans. The catch up amounts increase as follows:

\$1,000 in 2002
\$2,000 in 2003
\$3,000 in 2004
\$4,000 in 2005
\$5,000 in 2006

An example would be a teacher fifty or older could contribute \$12,000 in year 2002 and up to \$20,000 come 2006. Incredible!!

403(b) and 457 Plan Contribution Percentage Changes.

Starting in 2002 the contribution limits, *as a percentage of pay*, are increased to 100% for 403(b) and 457 plans. The percentage limits were much lower and were based on an extremely complex set of

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calculations.

Thankfully the new law simplifies the whole thing and the practical effect is that those who wish to pay more into their plans may do so, without worrying about exceeding a percentage, so long as they don't exceed the dollar limits. (For more on this see the article on the back page by John Clouden.)

SIMPLE IRA Changes.

The limits on SIMPLE IRAs are also being increased from the current annual limit of \$6,500. Starting next year the limits will increase as follows:

- \$ 7,000 in 2002
- \$ 8,000 in 2003
- \$ 9,000 in 2004
- \$10,000 in 2005

There will also be a catch up provision for those fifty and older as follows

- \$ 500 in 2002
- \$ 1,000 in 2003
- \$ 1,500 in 2004
- \$ 2,000 in 2005
- \$ 2,500 in 2006

These enhancements make SIMPLE IRAs much more attractive, especially for smaller, owner operated businesses.

529 Plan Changes

Beginning in 2002, withdrawals from 529 College Savings Plans will be tax free provided the withdrawals are for qualified higher education expenses. Currently, the earnings are taxed at the income tax rate of the student. This is an incredible improvement.

Changes of beneficiary used to be allowed only to direct family members, i.e. sister, brother, mother, father. This has been revised to include cousins. An example of the advantages this affords would be the case of grandparents establishing a plan and later being able to change beneficiaries amongst all their grandchildren.

Education IRA Enhancements.

First and foremost, the annual contribution amount for an Education IRA increases to \$2,000 next year from the current \$500 level. Withdrawals taken for education expenses will be tax free. In addition, they may be used for grade school and high school as well as college and post secondary education. Withdrawals still must be taken by age thirty, but they can be transferred to another beneficiary provided they are family members. Income eligibility limits for those contributing will be as follows: single filers can earn up

to \$110,000 while joint filers may earn up to \$220,000. Fantastic improvement!

Estate Tax Changes

Estate Taxes are the taxes paid when the assets of someone who has passed away transfer to the deceased person's heirs. There is a lot of debate in the political arena on this one and it is going to continue. One very important point to keep in mind is that estate taxes and income taxes are separate taxes. This becomes a factor when large portions of an estate are held in qualified retirement accounts, most notably IRAs, 401(k), 403(b) and 457 plans. Because these assets are taxed on withdrawal, the planning for their distribution must be carefully set up ahead of time or one could easily see the assets taxed on both the estate and income tax level.

Currently, estates of less than \$675,000 escape estate taxes. Once they exceed that level the estate taxes kick in on a graduated basis going up to 55%. Starting next year the exemption amount and the top tax rates will be as follows:

- \$1,000,000 in 2002 - 50% Top Tax Rate
- \$1,000,000 in 2003 - 49% Top Tax Rate
- \$1,500,000 in 2004 - 48% Top Tax Rate
- \$1,500,000 in 2005 - 47% Top Tax Rate
- \$2,000,000 in 2006 - 46% Top Tax Rate
- \$2,000,000 in 2007 - 45% Top Tax Rate
- \$2,000,000 in 2008 - 45% Top Tax Rate
- \$3,500,000 in 2009 - 45% Top Tax Rate
- Unlimited in 2010 - Repealed - No Tax Due
- \$1,000,000 in 2011 - 55% Top Tax Rate

As you can see, there is definite improvement in the tax, but the reversion in year 2011 back to the 2002 rates is a politically motivated, careless disregard for the well-being of our senior citizens. We fully expect this to be debated for years to come and hope that the politicians will control their spending, maintain some fiscal discipline and not bring the estate tax back in 2011.

The Economic Growth and Tax Relief Reconciliation Act of 2001 is over nine hundred pages long and there is even something of a tax cut in it. But from our perspective, the big news is the retirement and education investment changes as outlined in this article. As always there is a lot of detail which we are still absorbing and will pass along to you, as best we can. If you have questions or believe you need to review your financial planning in light of these tax law enhancements, please give us a call. ☺☺☺☺☺

A personal letter from Joe

Dear Friend,

The current state of the stock market makes careful planning and team work all the more important. This has been the most difficult period of my thirty plus year financial career. However, myself and my firm remain committed to equity investing, especially through well managed funds. I continue to view this current market as a great buying opportunity for the long term investor. It can be trying for all of us, but in the long run we think patient and persistent investors will be rewarded in the future, just as they have been in the past.

On June 6th, President Bush signed into law the Economic Growth and Tax Relief Reconciliation Act of 2001. While I welcome the modest income tax relief this new law does provide, it is not nearly enough. During the last eight years our tax burden increased to its highest levels since World War II. Federal spending increased by some eight percent last year alone and the politicians in Washington are still acting as though we don't pay enough. The harmful effects of this become even more acute in a county like ours, where the combined federal, state and local taxes easily consume fifty percent or more of our incomes. So I am calling on our elected officials to please decrease the spending, cut the taxes and pay off the debt. I especially hope that our two United States Senators will reconsider their positions, as neither one would support even these small tax reductions.

That said, let's get on to the really good news. We are extremely excited about the pension changes contained in this new law. The 401(k), 403(b) (TSA) and 457 (Deferred Compensation) limits being raised to \$11,000 next year (\$12,000 if 50 or older) and \$15,000 by 2006 (\$20,000 if 50 or older) are incredible. The IRA (regular and Roth) increases to \$3,000 next year (\$3,500 if 50 or older) and to \$5,000 by 2008 (\$6,000 if 50 or older) are well overdue. The complications removed from pension law were a wonderful surprise. And, the incredible improvements in the educational IRAs (\$500 limit raised to \$2,000 beginning 1/1/02) and 529 college plans were the most pleasant shockers (especially the 100% federal tax-free withdrawal provision if used for approved educational expenses). **TOTALLY AWESOME!**

For most of us, our biggest financial priorities are getting our kids through school and having a totally secure retirement. This new tax bill helps us accomplish our objectives better than any I have seen. And, within 3 to 5 years, pension contributions will be so significantly higher than they are now, that the stock market will likely get its rocket fuel back. Where else will this money go? I am really excited! Long term, I am more bullish now than ever before. If you have not been in recently, please call us soon to schedule an appointment so we can tailor these positive changes to your personal financial plan.

All the best,

A handwritten signature in black ink, appearing to read "Joe". The signature is stylized with a large, looping initial "J" and a trailing "e".

Make it S.I.M.P.L.E.

By Jeffrey Hahn

Saving for retirement is often inconvenient. I suspect that is partly why some fifty percent of our country's workforce is not covered under any pension plan at all. Encouraging retirement savings is one of the reasons I believe the recent retirement changes were enacted. Savings Incentive Match Plans for Employees - SIMPLE IRAs, have proven very effective plans for small business since they were first introduced in 1997. For those companies that started early, the assets in their employees accounts have grown significantly. Often times these accounts represent the major portion of their retirement savings. The enhancements in the new legislation along with the increases for Roth IRAs and improvement in Education IRAs afford the vast majority of people employed at small businesses the chance to create a very well rounded and powerfully structured financial plan. A plan that is easily administered and easy to understand. So if your business employs less than 100 people, making it SIMPLE may be the way to go. And remember, the market usually rewards those who stick with it, even in times like these. So stay at it and call whenever you need help.

403(B) Corner

By: John Clouden

With the passing of the new tax law comes many changes to the Tax Sheltered Annuity. Section 403(b) of the tax code has been streamlined to make calculations much more user friendly. We look forward to 2002 when the Maximum Exclusion Allowance (MEA) will be completely eliminated. The paperwork for our clients making contributions to their 403b will be greatly reduced (it will also make the business office very happy as well). One of the biggest changes is how the calculation for contributions can be made. Starting 1/1/2002, the maximum contribution will be 100% of salary up to \$11,000. This liberalization expands the ability for almost everyone to put away the maximum amount if they choose to. In addition, if you are currently contributing the maximum to your TSA and are 50 years of age or older, beginning 1/1/2002, you may be able to increase your contributions even further. We are very excited about the new changes to the TSA marketplace and have been anticipating them for many years. Now that these positive changes have taken place, it is even more important for you to schedule in at least once per year to review your investments and options available to you.

Saving for College

By Pat Sgroi

Wow! It's hard to believe how quickly the landscape for college planning has changed. In past years, I almost never recommended an Education IRA for any of my clients. The combination of the low contribution amount (\$500/yr) and distributions being restricted to higher education only (taxable) just didn't make it a good fit for most people.

*Now, with the limit being increased from \$500 to \$2,000/yr and the liberalization allowing parents to access the monies for elementary and secondary school expenses **tax-free** it becomes an awesome option.*

*In addition, the 529 College Savings Plan has been amended to allow for distributions to be taken out for qualified higher education expenses federally income **tax free!***

Please contact us with any questions you may have about how you & your family might benefit from one or both of these powerful college savings plans.

West Seneca Rotary Foundation

By Joe Sgroi

Several years ago, a few fellow Rotarians and I started a charitable foundation with the purpose of helping our community. Shortly thereafter, Carl Lambein, the owner of the Southgate Plaza donated a large parcel of land on the West Seneca- Orchard Park border along Southwestern Boulevard. He requested that the foundation use this land to build a golf course which would be open to the public and the proceeds from the course be used to benefit the community. We accepted this immense challenge and the project has grown from there. We will have a championship 18 hole course, plus a three hole teaching facility and short game area along with a golf learning center and club house. In addition, we will be part of the nationally acclaimed First Tee Program. First Tee, whose honorary chairman is former President Bush and whose national spokesperson is Tiger Woods, is a program designed to teach golf and important life skills to children. It is a great fit for what we are trying to accomplish, and you know how much I love kids☺!

We now own 260 acres of prime land and have approval of the site plan. Our goal is to start building the course this year, but we need your help. We have been working diligently to raise funds for this huge endeavor and your donation would be greatly appreciated. Please make your tax deductible (which always helps☺) check to "West Seneca Rotary Foundation Inc" and mail to my attention at Post Office Box 470, West Seneca, NY 14224. Thanks for helping me continue to make Western New York a great place to live, work and raise our families.