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Highlights of 2001 Tax Changes

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Introduction

This publication highlights tax law changes that take effect in 2001, 2002, and later years. The chapters are divided into separate sections based on when the changes take effect.

During 2001, many changes to the tax law were considered by Congress. Several of our publications and instructions to tax forms contained ***Cautions*** about possible changes in the law. The changes to the law that Congress made are explained in this publication.

Many of the changes discussed in this publication resulted from the Economic Growth and Tax Relief Reconciliation Act of 2001. The Act included a ***sunset provision*** in order to comply with the Congressional Budget Act of 1974. This provision states that the changes from the Act will not apply in tax years beginning after 2010 unless extended by future legislation.

Some of the changes covered in this publication include the following.

- Tax rate reductions.
- Changes to various credits including the earned income credit, adoption credit, and child tax credit.
- Changes to the student loan interest deduction.
- Changes to estate tax rates over the next few years and the eventual repeal of estate taxes.
- Increase in the allowable amount of individual retirement arrangement (IRA) contributions.
- Higher contribution and benefit limits for retirement plans.
- Additional contributions to retirement plans allowed for those age 50 and over.

See the discussion of each topic for more information.

Adjusting your withholding or estimated tax payments for 2002. If your tax for 2002 will be more or less than your 2001 tax, you may need to adjust your withholding or estimated tax payments accordingly. If your tax will decrease, you can get the benefit of lower taxes throughout

the year. If you will owe more tax, you can avoid a penalty when you file your tax return.

See the following table for forms and publications that will help you adjust your withholding or estimated tax payments. See chapter 7 for information on ordering forms and publications.

To adjust your....	Get Form...	And Publication...
Withholding	**W–4,** *Employee's Withholding Allowance Certificate*	**919,** *How Do I Adjust My Tax Withholding?*
Estimated tax payments	**1040–ES,** *Estimated Tax for Individuals*	**505,** *Tax Withholding and Estimated Tax*

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1–800–THE–LOST (1–800–843–5678)** if you recognize a child.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

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1. Tax Changes for Individuals

2001 Changes

Income Tax Rates Reduced

For tax years beginning in 2001, the income tax rates have been reduced. The following items highlight these changes.

10% tax rate. A portion of your income that would be subject to the 15% tax rate is subject to a reduced rate of 10%. For 2001, most individuals received the benefit of the 10% rate through an advance payment of income tax. Those individuals who did not receive the maximum advance payment may be able to claim the rate reduction credit, discussed below. After 2001, the 10% tax rate will be reflected in the tax tables and tax rate schedules.

Other tax rates. The other tax rates, 28%, 31%, 36%, and 39.6% are reduced in 2001 and later years as shown in the following table.

Tax year beginning in:	28%	31%	36%	39.6%
2001	27.5%	30.5%	35.5%	39.1%
2002 or 2003	27.0%	30.0%	35.0%	38.6%
2004 or 2005	26.0%	29.0%	34.0%	37.6%
2006 or later year	25.0%	28.0%	33.0%	35.0%

Rate Reduction Credit

Generally, you receive the benefits of the new 10% tax rate by claiming the rate reduction credit on your 2001 tax return. However, you must reduce the credit by any ***advance payment*** of income tax you received (before offset) in 2001. The advance payment is not subject to federal income tax.

You cannot claim the rate reduction credit if the advance payment is equal to the amount shown for your 2001 filing status.

- Single or married filing separately—$300.
- Head of household—$500.
- Married filing jointly or qualifying widow(er)—$600.

If you did not receive the amount shown, use the *Rate Reduction Credit Worksheet* in your form instructions to figure your credit.

Dependents. If you, or your spouse if filing a joint return, can be claimed as a dependent on someone else's return, you cannot claim the credit. Figure your tax using the *Tax Computation Worksheet for Certain Dependents* in your form instructions, unless you, or your spouse if filing a joint return, received an advance payment of income tax during 2001. For more information, see your form instructions or chapter 38 of Publication 17, *Your Federal Income Tax.*

Standard Deduction Amount Increased

The standard deduction for taxpayers who do not itemize deductions on Schedule A of Form 1040 is, in most cases, higher for 2001 than it was for 2000. The amount depends on your filing status, whether you are 65 or older or blind, and whether an exemption can be claimed for you by another taxpayer. The *2001 Standard Deduction Tables* are shown in Publication 501, *Exemptions, Standard Deduction, and Filing Information.*

Limit on Itemized Deductions Increased

If your adjusted gross income is above a certain amount, you lose all or part of your itemized deductions. In 2001, this amount is increased to $132,950 ($66,475 if married

filing separately). In 2000, the amounts were $128,950 and $64,475, respectively. For more information and a worksheet to figure the amount you can deduct, see the instructions for line 28 of Schedule A (Form 1040).

Exemption Amount Increased

The amount you can deduct for each exemption has increased from $2,800 in 2000 to $2,900 in 2001.

You lose all or part of the benefit of your exemptions if your adjusted gross income is above a certain amount. The amount at which the phaseout begins depends on your filing status. For 2001, the phaseout begins at $99,725 for married persons filing separately, $132,950 for single individuals, $166,200 for heads of household, and $199,450 for married persons filing jointly. If your adjusted gross income is above this amount, use the *Deduction for Exemptions Worksheet* in the Form 1040 instructions to figure the amount you can deduct for exemptions.

Standard Mileage Rate Increased

For 2001, the standard mileage rate for the cost of operating your car, van, pickup, or panel truck is increased to 34½ cents a mile for all business miles.

Car expenses and use of the standard mileage rate are explained in chapter 4 of Publication 463, *Travel, Entertainment, Gift, and Car Expenses.*

Tax Benefits for Parents of Kidnapped Children

A child who has been kidnapped may still qualify you for the following tax benefits.

- The exemption deduction for a dependent.
- Head of household or qualifying widow(er) with dependent child filing status.
- The child tax credit.
- The earned income credit.

Both of the following statements must be true.

1) The child must be presumed by law enforcement authorities to have been kidnapped by someone who is not a member of your family or the child's family.
2) The child must have qualified as your dependent for the part of the year before the kidnapping (or, in the case of the earned income credit and filing status determinations, the child must have lived with you for more than half of the part of the year before the kidnapping).

If both statements are true, then the child is treated as your dependent for the year. The child is also treated as continuing to live with you after the kidnapping. This may enable you to qualify for the tax benefits listed above.

This special treatment for a kidnapped child applies until the child is returned. However, the last year this treatment can apply is the earlier of:

1) The year the child is determined to be dead, or
2) The year the child would have reached age 18.

For details, see Publication 501, *Exemptions, Standard Deduction, and Filing Information.* For more information about the earned income credit, see Publication 596, *Earned Income Credit (EIC).* For more information about the child tax credit, see the instructions for Form 1040 or Form 1040A.

Holocaust Victims Restitution

Payments received by Holocaust victims (or their heirs) as restitution for Nazi persecution are not taxable. You also do not include them in any computations in which you would ordinarily add excludable income to your adjusted gross income, such as the computation to determine the taxable part of social security benefits. For more information, see Publication 525, *Taxable and Nontaxable Income.*

Lower Capital Gain Tax Rates

Beginning in 2001, the 10% capital gain rate is lowered to 8% for qualified **5-year gain**. Qualified 5-year gain is long-term capital gain from the sale of property that you held for more than 5 years and that would otherwise be subject to the 10% or 20% capital gain rate.

18% rate. Beginning in 2006, the 20% capital gain rate will be lowered to 18% for qualified 5-year gain from property with a holding period that begins after 2000.

Election to recognize gain on stock held on January 1, 2001. If you held any readily tradable stock on January 1, 2001, you can elect to treat it as sold on January 2, 2001, and then reacquired on that date. The stock must be a capital asset. The purpose of the election is to make any future gain on the stock eligible for the 18% rate by giving the stock a new holding period. Any gain on the deemed sale must be recognized. However, any loss is not allowed.

For more information on this election, see chapter 4 of Publication 550, *Investment Income and Expenses.*

Student Loan Interest Deduction

If you pay interest on a student loan, you may be able to deduct part or all of the interest you paid. The maximum amount you can deduct for student loan interest increased to $2,500 in 2001. The deduction was limited to $2,000 in 2000. For more information, see chapter 3 in Publication 970, *Tax Benefits for Higher Education*.

Employee Business Expenses

Increased section 179 deduction. The total cost of section 179 property that you can elect to deduct is increased from $20,000 to $24,000 for 2001 and 2002. Beginning in 2003, the total amount you can elect to deduct under section 179 will increase to $25,000.

For more information on the section 179 deduction, see chapter 2 in Publication 946, *How To Depreciate Property*.

Election not to apply the mid-quarter convention under MACRS. If you file your 2001 return on a calendar year basis, or on a fiscal year basis or for a short tax year and the third or fourth quarter of your 2001 tax year includes September 11, 2001, you can elect to apply the half-year convention to all property placed in service during

the year that would otherwise be subject to the mid-quarter convention under MACRS. See *Which Convention Applies?* and *Using the Applicable Convention in a Short Tax Year* in chapter 3 of Publication 946, *How To Depreciate Property*.

Self-Employment Tax

The self-employment tax rate on net earnings remains the same for 2001. This rate, 15.3%, is a total of 12.4% for social security (old-age, survivors, and disability insurance) and 2.9% for Medicare (hospital insurance).

Earnings limit. The maximum amount subject to the social security part for tax years beginning in 2001 has increased to $80,400. All net earnings of at least $400 are subject to the Medicare part.

Child Tax Credit Increased

The maximum child tax credit for each qualifying child is increased from $500 to $600 for 2001. For more information on the child tax credit, see the Form 1040 or Form 1040A instructions.

Additional Child Tax Credit Expanded

The additional child tax credit has been expanded for 2001 to include taxpayers with fewer than three qualifying children. If you have taxable earned income of more than $10,000, you may be able to claim the credit. Previously, you had to have three or more qualifying children to claim the additional child tax credit.

The additional child tax credit may give you a refund even if you do not owe any tax. You must use Form 8812 to claim the additional child tax credit. For more information, see the Form 8812 instructions.

Effect of Additional Child Tax Credit on Welfare Benefits

Any refund you receive as a result of taking the additional child tax credit will not be considered income when determining if you are eligible for the following programs, or how much you can receive from them. However, if the amounts you receive are not spent within a certain period of time, they may count as an asset (or resource) and affect your eligibility.

- Temporary Assistance for Needy Families (TANF).
- Medicaid and supplemental security income (SSI).
- Food stamps and low-income housing.

Postponed Tax Deadlines in Disaster Areas

The IRS may postpone for up to 1 year certain tax deadlines of taxpayers who are affected by a Presidentially declared disaster. The tax deadlines the IRS may postpone include those for filing income and employment tax returns, paying income and employment taxes, and making contributions to a traditional IRA or Roth IRA.

If any tax deadline is postponed, the IRS will publicize the postponement in your area and publish a news release, revenue ruling, revenue procedure, notice, announcement, or other guidance in the Internal Revenue Bulletin (IRB).

For more information on who may be eligible for the postponement, see Publication 547, *Casualties, Disasters, and Thefts.*

Tax Relief for Victims of Terrorist Attacks

The *Victims of Terrorism Tax Relief Act of 2001* provides tax relief for those injured or killed as a result of terrorist attacks, certain survivors of those killed as a result of terrorist attacks, and others who were affected by terrorist attacks.

The Act does the following.

1) Forgives federal income tax liabilities of individuals who die as a result of:
   a) The April 19, 1995, attack on the Alfred P. Murrah Federal Building (Oklahoma City),
   b) The September 11, 2001, terrorist attacks against the United States, or
   c) The terrorist attacks involving anthrax occurring after September 10, 2001, and before January 1, 2002.
2) Provides for the tax-free treatment of the following types of income.
   a) Qualified disaster relief payments made after September 10, 2001, to cover personal, family, living, or funeral expenses incurred because of a terrorist attack.
   b) Certain disability payments received in tax years ending after September 10, 2001, for injuries sustained in a terrorist attack.
   c) Certain death benefits paid by an employer to the survivor of an employee because the employee died as a result of a terrorist attack.
   d) Debt cancellations made after September 10, 2001, and before January 1, 2002, if the debts were cancelled because an individual died as a result of a terrorist attack.
   e) Payments from the September 11th Victim Compensation Fund of 2001.
3) Allows the IRS to postpone for up to 1 year certain tax deadlines of taxpayers who are affected by a terrorist attack.
4) Reduces the estate tax of individuals who die as a result of the Oklahoma City terrorist attack, the September 11 terrorist attack, and the anthrax attacks.

More information. For more information on these relief provisions and methods for claiming tax refunds, see Publication 3920, *Tax Relief for Victims of Terrorist Attacks.* This publication should be available by March 2002.

Table 1–1. **SECTION I–C Inflation-Indexed Debt Instruments**

Name of Issuer	CUSIP No.	Issue Date	Maturity Date	Issue Price	Stated Interest Rate	Total OID to 1/1/2001	2001 1st Period	2001 2nd Period	2001 3rd Period	Calendar Year 2001
U.S. Treasury	9128272M3	02/06/97	01/15/07	100.104	3.375	98.24	0.020360	0.112151	0.016288	23.35
U.S. Treasury	9128273A8	07/15/97	07/15/02	100.000	3.625	86.45	0.020141	0.110947	0.016113	23.10
U.S. Treasury	9128273T7	01/15/98	01/15/08	100.000	3.625	77.03	0.019967	0.109985	0.015974	22.90
U.S. Treasury	912810FD5	04/15/98	04/15/28	100.000	3.625	75.80	0.084815	0.070049	0.015853	22.88
U.S. Treasury	9128274Y5	01/15/99	01/15/09	100.000	3.875	60.98	0.019669	0.108346	0.015736	22.56
U.S. Treasury	912810FH6	04/15/99	04/15/29	100.000	3.875	58.44	0.083446	0.068918	0.015597	22.51
U.S. Treasury	9128275W8	01/18/00	01/15/10	100.006	4.250	34.21	0.019173	0.105612	0.015339	21.99
U.S. Treasury	9128276R8	01/16/01	01/15/11	100.002	3.500	0.00		0.102092	0.014827	20.98
U.S. Treasury	912810FQ6	10/15/01	04/15/32	100.000	3.375	0.00			0.014446	1.13

Afghanistan Designated a Combat Zone

By Executive Order No. 13239, Afghanistan is designated as a combat zone beginning September 19, 2001. For more information on benefits available to members of the Armed Forces serving in combat zones, see Publication 3, *Armed Forces' Tax Guide*.

Mailing Your Return

You may be mailing your return to a different service center this year because the IRS has changed the filing location for several areas. If you received an envelope with your tax package, please use it. Otherwise, see *Where Do You File?* on the back cover of your instruction booklet.

Disclosure to Third Parties

You can now allow the IRS to disclose tax returns and return information to a third party (designee) by oral authorization. Previously, your authorization had to be in writing. Third parties include any person accompanying you to a meeting or interview or participating with you in a telephone conversation with the IRS. Before any disclosure of information, the IRS must verify the following.

- The date, nature, and extent of information or assistance requested.
- The return or return information to be disclosed.
- Your identity and the identity of your designee.

Note. Your recognized representative or the individual who holds your power of attorney ***may not*** execute this consent of disclosure unless it is specifically authorized in the original power of attorney. A designee is not permitted this verbal authorization.

Election Out of Installment Method

For sales occurring after December 16, 1999, accrual basis taxpayers were required to report installment sales under the accrual method of accounting. The Installment Tax Correction Act of December 28, 2000, repealed that requirement.

If you entered into an installment sale after December 16, 1999, and filed an income tax return by April 16, 2001, reporting the sale on an accrual method, you have IRS approval to revoke your effective election out of the installment method.

To revoke the election, you must file an amended return for the year of the installment sale (and any other year affected by the sale), reporting the gain on the installment method. You generally have 3 years from the due date of the original return to file an amended return.

For more information on installment sales, see Publication 537, *Installment Sales.*

Securities Futures Contracts

A securities futures contract is a new financial product that is a contract of sale for future delivery of a single security or of a narrow-based security index. Gain or loss from the sale or exchange of the contract will generally have the same character as gain or loss from transactions in the property to which the contract relates. Any capital gain or loss on a sale or exchange of the contract will be considered short-term, regardless of how long you hold the contract. For more information, see chapter 4 of Publication 550, *Investment Income and Expenses.*

Original Issue Discount on Inflation-Indexed Debt Instruments

When Publication 1212, *List of Original Issue Discount Instruments,* was printed, *SECTION I–C, Inflation-Indexed Debt Instruments,* was not included. The OID on inflation-indexed instruments for 2001 is now available. See Table 1–1.

Medical Savings Accounts Program Extended and Renamed

A medical savings account (MSA) is a tax-exempt trust or custodial account with a financial institution (like a bank or an insurance company) in which you can save money for future medical expenses. To qualify for an MSA, you must be an employee of a small employer or self-employed. You must also have a high deductible health plan and have no

other health insurance coverage except permitted coverage. The pilot project for MSAs was scheduled to end December 31, 2000, but has been extended until December 31, 2002. MSAs have also been renamed **Archer MSAs**. You can find more information about MSAs in Publication 969, *Medical Savings Accounts (MSAs).*

Education IRAs Renamed

Education individual retirement accounts (IRAs) have been renamed Coverdell education savings accounts (Coverdell ESAs). For more information about Coverdell ESAs, see chapter 4 in Publication 970, *Tax Benefits for Higher Education*.

Third Party Designee

You can now allow the IRS to discuss your 2001 tax return with a friend, family member, or any person you choose by checking the "Yes" box in the "Third Party Designee" area where you sign your return. But if you want to allow the paid preparer who signed your return to discuss it with the IRS, just enter "Preparer" in the space for the designee's name. See your income tax package for more information.

2002 Changes

Standard Mileage Rate

For 2002, the standard mileage rate for the cost of operating your car, van, pickup, or panel truck is increased to 36½ cents a mile for all business miles.

Car expenses and use of the standard mileage rate are explained in chapter 4 of Publication 463, *Travel, Entertainment, Gift, and Car Expenses.*

Social Security and Medicare Taxes

For 2002, the employer and employee will continue to pay:

1) 6.2% each for social security tax (old-age, survivors, and disability insurance), and
2) 1.45% each for Medicare tax (hospital insurance).

Wage limits. For social security tax, the maximum amount of 2002 wages subject to the tax has increased to $84,900. For Medicare tax, all covered 2002 wages are subject to the tax. For information about these taxes, see Publication 15, *Circular E, Employer's Tax Guide.*

Survivor Benefits for Public Safety Officers

For tax years beginning after 2001, a survivor annuity received by the spouse, former spouse, or child of a public safety officer killed in the line of duty will generally be excluded from the recipient's income regardless of the date of the officer's death. Survivor benefits received before 2002 are excludable only if the officer died after 1996. For more information, see *Public safety officers,* in Publication 559, *Survivors, Executors, and Administrators.*

Retirement Planning Services

Beginning in 2002, if your employer has a qualified retirement plan, qualified retirement planning services provided to you (or your spouse) by your employer will not be included in your income. Qualified retirement planning services include retirement planning advice and information. However, the value of any tax preparation, accounting, legal, or brokerage services provided by your employer will still be included in your income. For more information about benefits your employer will not include in your income, see *Fringe Benefits* in Publication 525, *Taxable and Nontaxable Income.*

Tax Benefits for Education

The following paragraphs explain the changes to tax benefits for education.

Employer-Provided Educational Assistance

The tax-free status of up to $5,250 of employer-provided educational assistance benefits each year for undergraduate-level courses was scheduled to end for courses beginning after 2001. This benefit has been extended indefinitely and, beginning in 2002, it also applies to graduate-level courses. For more information, see chapter 7 in Publication 970, *Tax Benefits for Higher Education*.

Qualified Tuition Programs (QTPs)

Beginning in 2002, changes apply to what were formerly known as qualified state tuition programs. For more complete information on QTPs, see chapter 8 in Publication 970, *Tax Benefits for Higher Education*.

Name change. Qualified state tuition programs are renamed qualified tuition programs (QTPs).

Distributions from state-maintained QTPs. A distribution from a QTP established and maintained by a state (or an agency or instrumentality of the state) can be excluded from income if the amount distributed is used for higher education. Previously, the beneficiary was required to pay tax on any earnings from a QTP unless the earnings were tax-free under some other provision of the law.

QTPs maintained by educational institutions. You can make contributions to a QTP established and maintained by one or more eligible educational institutions. Any earnings distributed before January 1, 2004, will be taxable. Previously, contributions could only be made to a QTP established and maintained by a state (or an agency or instrumentality of the state).

Rollovers of QTPs to family members. For purposes of rollovers and changes of designated beneficiaries, the definition of family members is expanded to include first cousins of the beneficiary.

Rollovers of QTPs without changing the beneficiary. Amounts in a QTP can be rolled over, tax free, to another QTP set up for the same beneficiary. However, the rollover of credits or other amounts from one QTP to another QTP

for the benefit of the same beneficiary cannot apply to more than one transfer within any 12-month period.

Qualified expenses. Calculation of the amount that is considered reasonable for room and board expenses has been changed. You must contact the educational institution for their qualified room and board costs.

Special needs beneficiaries. The definition of "qualified higher education expenses" has been expanded to include expenses of a special needs beneficiary that are necessary for that person's enrollment or attendance at an eligible institution.

Coordination with Coverdell ESAs. You can make contributions to QTPs and Coverdell ESAs in the same year for the same beneficiary. Previously, you could only make contributions to one program or the other.

Coverdell ESAs (Formerly Education IRAs)

Beginning in 2002, the following changes apply to Coverdell education savings accounts (Coverdell ESAs). For more complete information on Coverdell ESAs, see chapter 4 in Publication 970, *Tax Benefits for Higher Education*.

Maximum contribution. The most you can contribute each year to a Coverdell ESA is increased from $500 to $2,000.

Income limits. If you file a joint return, the amount you can contribute to a Coverdell ESA will be phased out (gradually reduced) if your modified adjusted gross income (MAGI) is more than $190,000 but less than $220,000. You will not be able to contribute to a Coverdell ESA if your MAGI is $220,000 or more. This is an increase in the phaseout range for married taxpayers filing joint returns (which was between $150,000 and $160,000 in 2001).

Contribution due dates. The final date on which you can make contributions to a Coverdell ESA for any year has been extended to the due date of your return for that year (not including extensions). If you are a calendar year taxpayer, you generally will have until April 15, 2003, to make your contribution for the 2002 tax year. In previous years, contributions were required to be made by December 31.

Correcting excess contributions. The 6% excise tax on excess contributions will not apply to any excess contributions withdrawn by June 1 of the following year if the earnings on the excess are also withdrawn. Previously, these amounts had to be withdrawn by the due date for the beneficiary's return or, if no return was required, by April 15 of the following year.

Qualified expenses. The definition of qualified education expenses has been expanded to include elementary and secondary education expenses. Qualified elementary and secondary education expenses include expenses for:

- Tuition, fees, academic tutoring, special needs services in the case of a special needs beneficiary, books, supplies, and other equipment incurred in connection with enrollment or attendance as an elementary or secondary school student at a public, private, or religious school,
- Room and board, uniforms, transportation, and supplementary items and services (including extended day programs) which are required or provided by a public, private, or religious school in connection with such enrollment or attendance, and
- The purchase of computer technology or equipment or Internet access and related services, if such technology, equipment, or services are to be used by the beneficiary and the beneficiary's family during any of the years the beneficiary is in school (not including expenses for computer software designed for sports, games, or hobbies unless the software is predominantly educational in nature).

Special needs beneficiaries. You can continue to make contributions to a Coverdell ESA for a special needs beneficiary after his or her 18th birthday.

You can also leave assets in a Coverdell ESA set up for a special needs beneficiary after the beneficiary reaches age 30.

Coordination with Hope and lifetime learning credits. You can claim the Hope or lifetime learning credit in the same year you take a tax-free distribution from a Coverdell ESA, provided the distribution from the Coverdell ESA is not used for the same expenses for which the credit is claimed. Previously, you could not claim the Hope or lifetime learning credit if you received a tax-free withdrawal from a Coverdell ESA and did not waive the tax-free treatment of the withdrawal.

Coordination with qualified tuition programs (QTPs). You can make contributions to Coverdell ESAs and qualified tuition programs in the same year for the same beneficiary. Previously, you could only make contributions to one program or the other.

New Deduction for Higher Education Expenses

Beginning in 2002, you may be able to deduct qualified tuition and related expenses paid during the year for yourself, your spouse, or a dependent, even if you do not itemize deductions on Schedule A, Form 1040.

Qualified tuition and related expenses. In general, qualified tuition and related expenses are tuition and fees paid for you, your spouse, or a dependent for whom you claim an exemption that are required for enrollment or attendance at an ***eligible educational institution***.

Student-activity fees and fees for course-related books, supplies, and equipment are included in qualified tuition and related expenses ***only*** if the fees must be paid ***to the institution*** as a condition of enrollment or attendance.

Eligible educational institution. An eligible educational institution is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the Department of Education. It includes virtually all accredited, public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell you if it is an eligible educational institution.

Adjustments to qualified expenses. You must reduce your qualified expenses by the amount of any tax-free

educational assistance you received. Tax-free educational assistance includes:

- Scholarships,
- Pell grants,
- Employer-provided educational assistance,
- Veterans' educational assistance, and
- Any other nontaxable payments (other than gifts, bequests, or inheritances) received for education expenses.

Expenses that do not qualify. Qualified tuition and related expenses do not include the cost of:

- Insurance,
- Medical expenses (including student health fees),
- Room and board,
- Transportation, or
- Similar personal, living, or family expenses.

This is true even if the fee must be paid to the institution as a condition of enrollment or attendance.

Qualified tuition and related expenses generally do not include expenses that relate to any course of instruction or other education that involves sports, games or hobbies, or any noncredit course. However, if the course of instruction or other education is part of the student's degree program, these expenses can qualify.

Maximum deduction. For tax years beginning in 2002 and 2003, you may be able to deduct up to $3,000 you paid for qualified tuition and related expenses as an adjustment to income. For 2004 and 2005, you may be able to deduct up to $4,000.

Income limits. For tax years beginning in 2002 and 2003, you can deduct up to $3,000 of qualified tuition and related expenses if your modified adjusted gross income (MAGI) is not more than $65,000 ($130,000 on a joint return). If your MAGI is more than $65,000 ($130,000 on a joint return), you cannot take the deduction.

For tax years beginning in 2004 and 2005, you can deduct up to $4,000 of qualified tuition and related expenses if your MAGI is not more than $65,000 ($130,000 on a joint return). If your MAGI is more than $65,000 ($130,000 on a joint return) but not more than $80,000 ($160,000 on a joint return), you can deduct up to $2,000 of qualified tuition and related expenses. If your MAGI is more than $80,000 ($160,000 on a joint return), you cannot take the deduction.

Modified adjusted gross income (MAGI). For purposes of this deduction, your MAGI is the adjusted gross income shown on your return plus any foreign earned income exclusion, foreign housing exclusion or deduction, exclusion of income for bona fide residents of American Samoa, and exclusion of income from Puerto Rico.

Coordination with credits and other deductions. You cannot deduct any amount for qualified tuition and related expenses for a year if:

- A Hope credit or lifetime learning credit is claimed with respect to expenses of the individual for whom the tuition and related expenses were paid, or
- You can deduct the expense under any other provision of the law.

Coordination with exclusions. You must reduce your qualified tuition and related expenses by:

- Expenses you used to figure the amount of interest on qualified U.S. savings bonds that you excluded from income because you used it to pay qualified higher education expenses,
- Expenses you used to figure the amount of any tax-free withdrawals from a Coverdell ESA, and
- Expenses you used to figure the portion of any distribution of earnings from a qualified tuition program (QTP) you exclude from income because the earnings were used to pay the beneficiary's qualified higher education expenses.

Limits on eligibility. You cannot claim the deduction for qualified tuition and related expenses if any of the following apply.

- Another taxpayer is entitled to claim an exemption for you as a dependent on his or her return. This is true even if the other taxpayer does not actually claim your exemption.
- Your filing status is married filing separate return.
- You are a nonresident alien and you have not elected to be treated as a resident alien for the tax year.

Year of deduction. Generally, you can deduct only those expenses for a year that are in connection with enrollment at an institution of higher education during the same year.

However, you can deduct expenses paid in a year if they are for an academic period beginning within the year or during the first three months of the next year.

Student name and ID number. To take the deduction, you must show on your income tax return the name and taxpayer identification number (usually the social security number) of the person for whom the expenses were paid.

Termination. This deduction is not available for tax years beginning after 2005.

Student Loan Interest Deduction

If you pay interest on a student loan, you may be able to deduct the interest as an adjustment to income. For more complete information on the student loan interest deduction, see chapter 3 in Publication 970, *Tax Benefits for Higher Education.*

Elimination of 60-month limit. Beginning in 2002, the requirement that you can only deduct student loan interest paid during the first 60 months that interest payments are required is eliminated.

Limit on deduction based on modified adjusted gross income. Beginning in 2002, the amount of your student loan interest deduction will be phased out (gradually reduced) if your modified adjusted gross income (MAGI) is between $50,000 and $65,000 ($100,000 and $130,000 if

you file a joint return). You will not be able to take a student loan interest deduction if your MAGI is $65,000 or more ($130,000 or more if you file a joint return). For 2001, the deduction was phased out if your MAGI was between $40,000 and $55,000 ($60,000 and $75,000 if you filed a joint return) and you could not take a student loan interest deduction if your MAGI was $55,000 or more ($75,000 or more if you filed a joint return).

Modified Adjusted Gross Income (MAGI). Prior to 2002, your MAGI for purposes of the student loan interest deduction was your adjusted gross income as shown on your return modified by adding back any:

1) Foreign earned income exclusion,
2) Foreign housing exclusion or deduction,
3) Exclusion of income for bona fide residents of American Samoa, and
4) Exclusion of income from Puerto Rico.

Beginning in 2002, you must also add back any deduction of qualified tuition and related expenses.

Meal Expenses When Subject to “Hours of Service” Limits

Generally, you can deduct only 50% of your business-related meal expenses while traveling away from your tax home for business purposes. You can deduct a higher percentage if the meals take place during or incident to any period subject to the Department of Transportation’s “hours of service” limits. (These limits apply to workers who are under certain federal regulations.) The percentage is 65% for 2002 and 2003. Business meal expenses are covered in chapter 1 of Publication 463, *Travel, Entertainment, Gift, and Car Expenses.*

Self-Employed Health Insurance Deduction

For 2002, this deduction increases to 70% of the amount paid for medical and qualified long-term care insurance for you and your family. After 2002, the deduction will increase to 100%. For more information, see chapter 7 in Publication 535, *Business Expenses*.

Earned Income Credit

The following paragraphs explain the changes to the earned income credit for 2002. The earned income credit for 2001 is explained in Publication 596, *Earned Income Credit.*

New definition of earned income. The amount of earned income credit you can claim is based, in part, on your ***earned income.*** For tax years after 2001, earned income will no longer include nontaxable employee compensation. Nontaxable employee compensation includes amounts such as salary deferrals and reductions, excludable dependent care benefits, and excluded combat pay.

Elimination of modified adjusted gross income (AGI). For tax years after 2001, you will no longer need to figure modified AGI. Your earned income credit will be figured using your AGI, ***not*** modified AGI.

New rules for persons with same qualifying child. For tax years after 2001, if two or more persons may be able to claim the same qualifying child, the qualifying child can be claimed only by:

1) The parents, if they file a joint return,
2) The parent, if only one of the persons is the child’s parent,
3) The parent with whom the child lived the longest during the year, if two of the persons are the child’s parent,
4) The parent with the highest AGI if the child lives with each parent for the same amount of time during the year, or
5) The person with the highest AGI, if none of the persons is the child’s parent.

New definition of foster child. For tax years after 2001, the definition of an eligible foster child is changed. The child will have to live with you only for more than half of the tax year. Previously, the child must have lived with you the entire year.

Reduction of EIC by alternative minimum tax eliminated. For tax years after 2001, your earned income credit will no longer be reduced by the amount of alternative minimum tax shown on your return.

Tax Benefits for Adoption Extended and Expanded

Under current law, you can take a tax credit for expenses paid to adopt a child. In addition, you can exclude from income certain amounts paid or reimbursed by your employer for qualifying adoption expenses under an adoption assistance program. Beginning in 2002, there are significant changes to the credit and exclusion.

Credit and exclusion now permanent. The credit, which was scheduled to end after 2001 (except for children with special needs), has been permanently extended. The exclusion, which was scheduled to end after 2001, has also been made permanent.

Amount of credit and exclusion increased. Beginning in 2002, the maximum credit and exclusion will increase to $10,000. Beginning in 2003, a $10,000 credit or exclusion will be allowed for the adoption of a child with special needs regardless of whether the taxpayer has qualifying expenses.

The income limit based on ***modified adjusted gross income (modified AGI)*** will also increase. The following table shows whether the income limit will affect the credit or exclusion.

IF your modified AGI is...	THEN the income limit...
$150,000 or less	Will not affect your credit or exclusion.
$150,001 to $189,999	Will reduce your credit or exclusion.
$190,000 or more	Will eliminate your credit or exclusion.

More information. The adoption credit and exclusion are explained in more detail in Publication 968, *Tax Benefits for Adoption.* The January 2002 revision of that publication will reflect the changes in the law. This revision should be available by March 2002.

Electric and Clean-Fuel Vehicles

The maximum clean-fuel vehicle deduction and qualified electric vehicle credit are 25% lower for 2002 than they were for 2001. Both the credit and the deduction will be phased out completely by 2005. For more information about electric and clean-fuel vehicles, see chapter 12 in Publication 535, *Business Expenses*.

Self-Employment Tax

The self-employment tax rate on net earnings remains the same for 2002. This rate, 15.3%, is a total of 12.4% for social security (old-age, survivors, and disability insurance) and 2.9% for Medicare (hospital insurance).

The maximum amount subject to the social security part for tax years beginning in 2002 has increased to $84,900. All net earnings of at least $400 are subject to the Medicare part.

Certain Withholding Rates Decreased

For 2002, the withholding rates on the following items have been decreased.

1) **Gambling winnings.** The rate is decreased to 27%.
2) **Unemployment compensation.** The rate is decreased to 10%.
3) **Federal payments.** Withholding on certain federal payments is voluntary. The elective rates are decreased to 7%, 10%, 15%, and 27%.
4) **Backup withholding.** The rate is decreased to 30%.
5) **Supplemental wages.** The rate is decreased to 27%.

Withholding on these items is discussed in chapter 1 of Publication 505, *Tax Withholding and Estimated Tax.*

Estimated Tax for Higher Income Taxpayers

For installment payments for tax years beginning in 2002, the estimated tax safe harbor for higher income individuals (other than farmers and fishermen) has been modified. If your 2001 adjusted gross income is more than $150,000 ($75,000 if married filing a separate return), you will have to pay the smaller of 90% of your expected tax for 2002 or ***112%*** of the tax shown on your 2001 return to avoid an estimated tax penalty. The estimated tax penalty is explained in chapter 4 of Publication 505, *Tax Withholding and Estimated Tax.*

Tax-Exempt Bond Financing for Qualified Public Educational Facilities

Beginning in 2002, the private activities for which state and local tax-exempt bonds may be issued will be expanded to include providing qualified public educational facilities.

A qualified public educational facility is any school facility that is:

1) Part of a public elementary school or a public secondary school, and
2) Owned by a private, for-profit corporation under a public-private partnership agreement with a state or local educational agency.

The issuer of the bond should be able to tell you whether the bond is tax-exempt.

Later Changes

Child and Dependent Care Credit Increase

Beginning in 2003, the following changes will be made to the child and dependent care credit.

- The credit amount can be as much as 35% (previously 30%) of your qualified expenses.
- The maximum adjusted gross income amount that qualifies for the 35% rate will be increased from $10,000 to $15,000.
- The limit on the amount of qualifying expenses will be increased from $2,400 to $3,000 for one qualifying individual and from $4,800 to $6,000 for two or more qualifying individuals.

For details on this credit, see Publication 503, *Child and Dependent Care Credit.*

Earned Income Credit

For tax years after 2003, the IRS will disallow your EIC if the Federal Case Registry of Child Support Orders shows that you are the noncustodial parent of a child claimed as a qualifying child for EIC. If, as the noncustodial parent you are eligible to claim EIC with a qualifying child in a later year, you will ***not*** have to file Form 8862 because the IRS used math error authority to disallow your EIC. For more information about when the IRS disallows your EIC, see chapter 5 of Publication 596, *Earned Income Credit.*

Standard Deduction Increase for Married Persons

Beginning in 2005, the standard deduction for a single individual and a married individual filing a separate return will be the same. The standard deduction for a married couple filing a joint return will gradually increase until, in 2009, it is twice the amount of the standard deduction for a single individual.

15% Tax Bracket Will Expand for Married Persons Filing Jointly

Beginning in 2005, the 15% income tax rate bracket for a married couple filing a joint return will be gradually expanded until, in 2008, it is twice the size of the 15% bracket for a single filer.

Elimination of Limit on Itemized Deductions

Beginning in 2006, the overall limit on certain itemized deductions will gradually be eliminated.

Elimination of Phaseout of Personal Exemptions

Beginning in 2006, the phaseout of exemptions for taxpayers whose adjusted gross income is above certain threshold amounts will gradually be eliminated.

2.

Tax Changes for Businesses

2001 Changes

Cash Method of Accounting

For tax years ending on or after December 31, 2001, a qualifying small business taxpayer can choose to use the cash method of accounting and not account for inventories. A qualifying small business taxpayer is any taxpayer with average annual gross receipts of more than $1,000,000 but less than or equal to $10,000,000 that is not prohibited from using the cash method of accounting under section 448 of the Internal Revenue Code. Certain other requirements must be met. For more information, see Notice 2001–76 in Internal Revenue Bulletin 2001–52. These rules do not apply to taxpayers with average annual gross receipts of $1,000,000 or less. They can use the cash method of accounting under Revenue Procedure 2001–10, which is discussed in Publication 538, *Accounting Periods and Methods.*

Election Out of Installment Method

For sales occurring after December 16, 1999, accrual basis taxpayers were required to report installment sales under the accrual method of accounting. The Installment Tax Correction Act of December 28, 2000, repealed that requirement.

If you entered into an installment sale after December 16, 1999, and filed an income tax return by April 16, 2001, reporting the sale on an accrual method, you have IRS approval to revoke your effective election out of the installment method.

To revoke the election, you must file an amended return for the year of the installment sale (and any other year affected by the sale), reporting the gain on the installment method. You generally have 3 years from the due date of the original return to file an amended return.

For more information on installment sales, see Publication 537, *Installment Sales.*

Standard Mileage Rate

For 2001, the standard mileage rate for the cost of operating your car, van, pickup, or panel truck is increased to 34½ cents a mile for all business miles.

Car expenses and use of the standard mileage rate are explained in chapter 4 of Publication 463, *Travel, Entertainment, Gift, and Car Expenses.*

Postponed Tax Deadlines

The IRS may postpone for up to 1 year certain tax deadlines of taxpayers who are affected by a Presidentially declared disaster or terrorist attack. The tax deadlines the IRS may postpone include those for filing income and employment tax returns, paying income and employment taxes, and making contributions to a traditional IRA or Roth IRA.

If any tax deadline is postponed, the IRS will publicize the postponement in your area and publish a news release, revenue ruling, revenue procedure, notice, announcement, or other guidance in the Internal Revenue Bulletin (IRB).

Redesignation of Estimated Tax Payments

As a result of the economic disruptions caused by the September 11, 2001, terrorist attacks, some taxpayers believe their tax liability for the current year will be lower than the total of the estimated tax payments they have already made.

The IRS will allow these taxpayers to redesignate their estimated tax payments as deposits of employment taxes and income taxes withheld. To redesignate estimated tax payments, a taxpayer should contact the IRS through its Disaster Relief toll-free number, **1–866–562–5227.**

If, as a result of the redesignation, the amount of the estimated tax payments is reduced below the amount required to pay the estimated tax obligation, the taxpayer may be liable for an underpayment penalty.

Lower Capital Gain Tax Rates

Beginning in 2001, the 10% capital gain rate is lowered to 8% for qualified **5-year gain**. Qualified 5-year gain is long-term capital gain from the sale of property that you held for more than 5 years and that would otherwise be subject to the 10% or 20% capital gain rate.

18% rate. Beginning in 2006, the 20% capital gain rate will be lowered to 18% for qualified 5-year gain from property with a holding period that begins after 2000.

Election to recognize gain on property held on January 1, 2001. A taxpayer (other than a corporation) who on January 1, 2001, held certain capital assets or property used in a trade or business can elect to treat the property as sold and then reacquired on that date. The purpose of the election is to make any future gain on the property eligible for the 18% rate by giving the property a new holding period. Any gain on the deemed sale must be recognized. However, any loss is not allowed.

For more information on this election, see chapter 4 of Publication 550, *Investment Income and Expenses.*

Rollover of Gain From Sale of Empowerment Zone Assets

You can choose to roll over certain gains from the sale of qualified empowerment zone assets purchased after December 21, 2000, if you meet all the following tests.

- You hold a qualified empowerment zone asset for more than 1 year and sell it at a gain.
- Your gain from the sale is a capital gain.
- During the 60-day period beginning on the date of the sale, you buy a replacement qualified empowerment zone asset in the same zone as the asset sold.

For more information about the rollover of gain from the sale of empowerment zone assets, see Publication 954, *Tax Incentives for Empowerment Zones and Other Distressed Communities.*

Depreciation and Section 179 Deduction

Increased section 179 deduction. The total cost of section 179 property that you can elect to deduct is increased from $20,000 to $24,000 for 2001 and 2002. Beginning in 2003, the total amount you can elect to deduct under section 179 will increase to $25,000.

For more information on the section 179 deduction, see chapter 2 in Publication 946, *How To Depreciate Property.*

Election not to apply the mid-quarter convention under MACRS. If you file your 2001 return on a calendar year basis, or on a fiscal year basis or for a short tax year and the third or fourth quarter of your 2001 tax year includes September 11, 2001, you can elect to apply the half-year convention to all property placed in service during the year that would otherwise be subject to the mid-quarter convention under MACRS. See *Which Convention Applies?* and *Using the Applicable Convention in a Short Tax Year* in chapter 3 of Publication 946, *How To Depreciate Property.*

Self-Employment Tax

The self-employment tax rate on net earnings remains the same for 2001. This rate, 15.3%, is a total of 12.4% for social security (old-age, survivors, and disability insurance) and 2.9% for Medicare (hospital insurance).

The maximum amount subject to the social security part for tax years beginning in 2001 has increased to $80,400. All net earnings of at least $400 are subject to the Medicare part.

2002 Changes

Standard Mileage Rate

For 2002, the standard mileage rate for the cost of operating your car, van, pickup, or panel truck is increased to 36½ cents a mile for all business miles.

Car expenses and use of the standard mileage rate are explained in chapter 4 of Publication 463, *Travel, Entertainment, Gift, and Car Expenses.*

Social Security and Medicare Taxes

For 2002, the employer and employee will continue to pay:

1) 6.2% each for social security tax (old-age, survivors, and disability insurance), and
2) 1.45% each for Medicare tax (hospital insurance).

Wage limits. For social security tax, the maximum amount of 2002 wages subject to the tax has increased to $84,900. For Medicare tax, all covered 2002 wages are subject to the tax. For information about these taxes, see Publication 15, *Circular E, Employer's Tax Guide.*

Meals While Subject to “Hours of Service” Limits

For 2002, you can deduct 65% of the reimbursed meals your employees consume while away from their tax home on business during, or incident to, any period subject to the Department of Transportation's “hours of service” limits. For more information, see chapter 13 in Publication 535, *Business Expenses.*

Self-Employed Health Insurance Deduction

For 2002, this deduction increases to 70% of the amount paid for medical and qualified long-term care insurance for you and your family. After 2002, the deduction will increase to 100%. For more information, see chapter 7 in Publication 535, *Business Expenses.*

General Business Credits

For tax years beginning after 2001, there are two new business credits.

Credit for Employer-Provided Child Care

You can receive a tax credit of 25% of the qualified expenses you paid for employee child care and 10% of qualified expenses you paid for child care resource and referral services. This credit cannot be more than $150,000 each year.

Qualified child care expenses. Expenses that qualify for this credit include the following.

- Expenses to acquire, construct, rehabilitate, or expand depreciable property for use as a qualified

child care facility. This property cannot be part of your or your employee's main home.

- Expenses to operate a qualified child care facility. Include the costs related to training employees, scholarship programs, and any increased compensation to employees with higher levels of child care training.
- Expenses paid to a qualified child care facility under contract to provide child care services to your employees.

Qualified child care expenses do not include expenses in excess of the fair market value of the care.

Qualified child care facility. A qualified child care facility is a facility that:

- Is used mainly to provide child care assistance,
- Has enrollment open to your employees,
- Has as its enrollees at least 30% of your employees' dependents, if the facility is your main trade or business,
- Does not discriminate in favor of your highly compensated employees, and
- Meets the requirements of all applicable laws and regulations, including the licensing of the facility as a child care facility.

Basis reduced. If you take a credit for expenses to acquire, construct, rehabilitate or expand a facility, you must reduce your basis in the facility by the amount of that credit.

Qualified child care resource and referral expenses. These expenses are amounts you paid or incurred under contract to provide child care resource and referral services to your employees. You cannot claim the credit on these expenses if the services offered discriminate in favor of your highly compensated employees.

Credit for Pension Plan Startup Costs

If you are an eligible employer who begins a new pension plan for your employees, you may be able to receive a tax credit of 50% of the first $1,000 of qualified startup costs of the plan. The credit is available for each of the first 3 years of the plan.

Eligible employer. You are an eligible employer if, during the preceding year, you had 100 or fewer employees who received at least $5,000 of compensation.

Qualified startup costs. Qualified startup costs are any ordinary and necessary expenses you pay to:

- Begin or administer an eligible employer plan, or
- Educate your employees about the plan.

Eligible employer plan. An eligible employer plan is a plan that meets the requirements of a defined benefit or defined contribution plan (including a 401(k) plan), SIMPLE plan, or simplified employee pension.

Work Opportunity Credit and Welfare-to-Work Credit

The work opportunity credit and the welfare-to-work credit are scheduled to expire for wages paid to individuals who began working for you after 2001.

Electric and Clean-Fuel Vehicles

The maximum clean-fuel vehicle deduction and qualified electric vehicle credit are 25% lower for 2002 than they were for 2001. Both the credit and the deduction will be phased out completely by 2005. For more information about electric and clean-fuel vehicles, see chapter 12 in Publication 535, *Business Expenses.*

Tax Incentives for Empowerment Zones and Renewal Communities

The Community Renewal Tax Relief Act of 2000 generally extends empowerment zone status for existing zones through 2009, provides new or enhanced tax benefits to businesses in empowerment zones, and authorizes up to nine new zones. The Act also authorizes up to 40 renewal communities in which businesses will be eligible for tax incentives such as a 15% credit on the first $10,000 of the wages of certain employees, special cost recovery for commercial revitalization expenses, an increased section 179 deduction, and paying no tax on any capital gain from the sale of certain qualifying assets. In addition, the Act creates a new markets tax credit for equity investments in qualified community development entities. For more information, see Publication 954, *Tax Incentives for Empowerment Zones and Other Distressed Communities.*

Increased Section 179 Deduction for Enterprise Zone Businesses

The dollar limit on the section 179 deduction is increased for 2002 and later years if your business qualifies as an enterprise zone business. The increase is the smaller of the following amounts.

- $35,000.
- The cost of section 179 property that is also qualified zone property.

For more information, see Publication 954, *Tax Incentives for Empowerment Zones and Other Distressed Communities.*

Environmental Cleanup Cost Deduction

The deduction for qualified environmental cleanup costs was scheduled to expire for costs paid or incurred after 2001. It has been extended to include costs you pay or incur before 2004. For more information about this deduction, see Publication 954, *Tax Incentives for Empowerment Zones and Other Distressed Communities.*

Self-Employment Tax

The self-employment tax rate on net earnings remains the same for 2002. This rate, 15.3%, is a total of 12.4% for social security (old-age, survivors, and disability insurance) and 2.9% for Medicare (hospital insurance).

The maximum amount subject to the social security part for tax years beginning in 2002 has increased to $84,900. All net earnings of at least $400 are subject to the Medicare part.

3. IRAs and Other Retirement Plans

2001 Change

Qualified Plans

Plan administrators are now required by the Internal Revenue Code to provide to employees written notice of plan amendments that significantly reduce the rate of future benefit accrual. For plan amendments taking effect after June 6, 2001, the employer or the plan will have to pay an excise tax if both of the following occur.

- A defined benefit plan or money purchase pension plan is amended to provide for a significant reduction in the rate of future benefit accrual.
- The plan administrator fails to notify the affected individuals and the employee organizations representing them of the reduction.

For more information, see chapter 4 in Publication 560, *Retirement Plans for Small Business.*

2002 Changes

New Credit for Contributions to Retirement Plans and IRAs (Saver's Credit)

Beginning in 2002, if you make eligible contributions (defined later) to an employer-sponsored retirement plan or to an individual retirement arrangement (IRA), you may be able to take a tax credit. The amount of the saver's credit you can get is based on the contributions you make and your credit rate. Your credit rate can be as low as 10% or as high as 50%, depending on your adjusted gross income. The lower your income, the higher the credit rate. Your credit rate also depends on your filing status. See Table 3–1 to determine your credit rate.

Table 3–1. **Saver's Credit Rate**

Caution*: The credit is limited to* ***$1,000*** *per person per year.*

IF your filing status is ...	AND your adjusted gross income is ...	THEN your credit rate is...
Married filing jointly	Not over $30,000	50%
	Over $30,000 but not over $32,500	20%
	Over $32,500 but not over $50,000	10%
	Over $50,000	0% (You do not qualify for the credit)
Head of household	Not over $22,500	50%
	Over $22,500 but not over $24,375	20%
	Over $24,375 but not over $37,500	10%
	Over $37,500	0% (You do not qualify for the credit)
Single, Qualifying widow(er), or Married filing separately	Not over $15,000	50%
	Over $15,000 but not over $16,250	20%
	Over $16,250 but not over $25,000	10%
	Over $25,000	0% (You do not qualify for the credit)

The maximum contribution taken into account is $2,000 per taxpayer. On a joint return, up to $2,000 is taken into account for each spouse.

Who cannot claim the credit. You cannot claim the credit if any of the following apply.

1) You are under age 18.
2) You are a full-time student (explained later).
3) Someone else, such as your parent(s), claims an exemption for you on their tax return.
4) Your adjusted gross income (defined later) is more than:

    a) $50,000 if your filing status is married filing jointly,

b) $37,500 if your filing status is head of household, or

c) $25,000 if your filing status is either single, married filing separately, or qualifying widow(er).

Full-time student. You are a full-time student if, during some part of each of 5 calendar months (not necessarily consecutive) during the calendar year, you are either:

- A full-time student at a school that has a regular teaching staff, course of study, and regularly enrolled body of students in attendance, or
- A student taking a full-time, on-farm training course given by a school that has a regular teaching staff, course of study, and regularly enrolled body of students in attendance or a state, county, or local government.

You are a full-time student if you are enrolled for the number of hours or courses the school considers to be full-time.

Adjusted gross income. This is generally the amount on the line labeled *adjusted gross income* at the bottom of page 1 of your 2002 Form 1040 or Form 1040A. However, you must add to that amount any exclusion or deduction claimed for the year for:

- Foreign earned income,
- Foreign housing costs,
- Income for residents of American Samoa, and
- Income from Puerto Rico.

Eligible contributions. These include contributions to a traditional or Roth IRA and salary reduction contributions to a 401(k) plan (including a SIMPLE 401(k)), a section 403(b) annuity, an eligible deferred compensation plan of a state or local government (a governmental 457 plan), a SIMPLE IRA plan, or a salary reduction SEP. They also include voluntary after-tax employee contributions to a tax-qualified retirement plan or section 403(b) annuity. For purposes of the credit, an employee contribution will be voluntary as long as it is not required as a condition of employment.

Contributions reduced. Your eligible contributions are reduced by the sum of:

- Any taxable distribution from a qualified retirement plan or from an eligible deferred compensation plan that you receive during the testing period (defined later), and
- Any distribution from a Roth IRA or a Roth account that you receive during the testing period and that is not a qualified rollover contribution to a Roth IRA or a rollover to a Roth account.

A distribution from a Roth IRA that is not rolled over reduces your eligible contributions, even if the distribution is not taxable.

A distribution that is a return of a contribution to an IRA (including a Roth IRA) made during the year for which you claim the credit does not reduce your eligible contributions if:

1) The distribution is made before the due date (including extensions) of your tax return for that year,
2) You do not take a deduction for the contribution, and
3) The distribution includes any income attributable to the contribution.

Distributions received by spouse. Any distributions your spouse receives are treated as received by you if you file a joint return with your spouse both for the year of the distribution and for the year for which you claim the credit.

Testing period. The testing period consists of the year for which you claim the credit, the period after the end of that year and before the due date (including extensions) for filing your return for that year, and the 2 tax years before that year.

Maximum eligible contributions. After your contributions are reduced, the maximum annual contribution on which you can base the credit is $2,000 per person.

Maximum credit. The amount of the credit in any year cannot be more than the amount of tax that you would otherwise pay (not taking into account any refundable credits or the adoption credit) in any year. If your tax liability is reduced to zero because of other nonrefundable credits, such as the Hope credit, then you will not be entitled to this credit.

Termination of credit. This credit is not available for tax years beginning after 2006.

Individual Retirement Arrangements (IRAs)

For more information about IRAs, see Publication 590, *Individual Retirement Arrangements (IRAs).*

Increased Traditional IRA Contribution and Deduction Limits

The most that can be contributed to your traditional IRA for 2002 is the lesser of:

- ***$3,000*** (up from $2,000), or
- Your compensation that you must include in income.

If you are 50 or older in 2002, the most that can be contributed to your traditional IRA for 2002 is the lesser of:

- ***$3,500*** (up from $2,000), or
- Your compensation that you must include in income.

For more information, see *How Much Can Be Contributed?* in chapter 1 of Publication 590.

Besides being able to contribute a larger amount in 2002, you may be able to deduct a larger amount. See *How Much Can I Deduct?* in chapter 1 of Publication 590.

Increased Roth IRA Contribution Limit

If contributions on your behalf are made only to Roth IRAs, your contribution limit for 2002 generally is the lesser of:

- ***$3,000*** (up from $2,000), or

- Your compensation that you must include in income.

If you are 50 or older in 2002 and contributions on your behalf are made only to Roth IRAs, your contribution limit for 2002 generally is the lesser of:

- ***$3,500*** (up from $2,000), or
- Your compensation that you must include in income.

However, if your modified adjusted gross income is above a certain amount, your contribution limit may be reduced. For more information, see *How Much Can Be Contributed?* in chapter 2 of Publication 590.

Increased Contributions to Both Traditional and Roth IRAs

If contributions are made on your behalf to both a Roth IRA and a traditional IRA, your contribution limit for 2002 is the lesser of:

- ***$3,000*** (***$3,500*** if you are 50 or older in 2002) (up from $2,000) minus all contributions (other than employer contributions under a SEP or SIMPLE IRA plan) for the year to all IRAs other than Roth IRAs, or
- Your compensation that you must include in income minus all contributions (other than employer contributions under a SEP or SIMPLE IRA plan) for the year to all IRAs other than Roth IRAs.

However, if your modified adjusted gross income is above a certain amount, your contribution limit may be reduced. For more information, see *How Much Can Be Contributed?* in chapter 2 of Publication 590.

Rollovers From Traditional IRAs Into Qualified Plans

You can roll over tax free a distribution from your traditional IRA made after 2001 into a qualified plan. The part of the distribution that you can roll over is the part that would otherwise be taxable (includible in your income). Qualified plans may, but are not required to, accept such rollovers. Rules applicable to other rollovers, such as the 60-day time limit, apply. For more information about rollovers, see *Rollovers* in chapter 1 of Publication 590.

Tax Treatment of Rollovers From an IRA Into an Eligible Retirement Plan Other Than an IRA

For distributions made after 2001, if you roll over a distribution from an IRA into an eligible retirement plan other than an IRA, the part of the distribution you roll over is considered to come first from amounts other than after-tax contributions in any of your traditional IRAs. This means you can roll over a distribution from an IRA with after-tax contributions into a qualified plan if you have enough taxable income in your other IRAs to cover the after-tax part. The effect of this is to maximize the amount in your traditional IRAs that you can roll over to a qualified plan.

Exception to the 60-Day Rollover Rule

Generally, a rollover is tax free only if you make the rollover contribution by the 60th day after the day you receive the distribution. Beginning with distributions after 2001, the IRS may waive the 60-day requirement where it would be against equity or good conscience not to do so.

For more information, see *Time Limit for Making a Rollover Contribution* in chapter 1 of Publication 590.

No Rollovers of Hardship Distributions Into IRAs

For distributions made after 2001, no hardship distribution can be rolled over into an IRA.

Qualified Plans

Deduction Limits Changed

For years beginning after 2001, the following deduction limits apply.

Profit-sharing plans. The maximum deduction for contributions to a profit-sharing plan increases from 15% to 25% of the compensation paid or accrued during the year to your eligible employees participating in the plan. Compensation for figuring the deduction for contributions includes elective deferrals.

Defined benefit plans. For plan years beginning after 2001, the maximum deduction for contributions can be as much as the plan's unfunded current liability.

Elective deferrals. Elective deferrals will not be subject to the deduction limits that apply to qualified plans. Also, elective deferrals are not taken into account when figuring the amount you can deduct for employer contributions that are not elective deferrals.

Elective Deferrals (401(k) Plans)

The limit on elective deferrals for participants in 401(k) plans (excluding SIMPLE plans) increases for tax years beginning after 2001. The limit for 2002 and later years is as follows.

Year	Limit
2002	$11,000
2003	12,000
2004	13,000
2005	14,000
2006 and later years	15,000

Note. The $15,000 limit is subject to adjustment after 2006 for cost-of-living increases.

Catch-up contributions. For tax years beginning after 2001, a plan can permit participants who are age 50 or over at the end of the plan year to make catch-up contributions. The catch-up contribution limit for 2002 and later years is as follows.

Year	Catch-Up Limit
2002	$1,000
2003	2,000
2004	3,000
2005	4,000
2006 and later years	5,000

Note. The $5,000 limit is subject to adjustment after 2006 for cost-of-living increases.

The catch-up contribution a participant can make for a year cannot exceed the lesser of the following amounts.

- The catch-up contribution limit.
- The excess of the participant's compensation over the elective deferrals that are not catch-up contributions.

Limits on Contributions and Benefits

For years beginning after 2001, the maximum annual benefit for a participant under a defined benefit plan increases to the lesser of the following amounts.

- 100% of the participant's average compensation for his or her highest 3 consecutive calendar years.
- $160,000 (subject to cost-of-living increases after 2002).

For years beginning after 2001, a defined contribution plan's maximum annual contributions and other additions (excluding earnings) to the account of a participant increases to the lesser of the following amounts.

- 100% of the compensation actually paid to the participant (up to a maximum of $200,000 for 2002 subject to cost-of-living increases after 2002).
- $40,000 (subject to cost-of-living increases after 2002).

Involuntary Payment of Benefits

A qualified plan may provide for the immediate distribution of a participant's benefit under the plan if:

- The participant's employment is terminated, and
- The present value of the benefit is not greater than $5,000.

For distributions made after 2001, benefits attributable to rollover contributions and earnings on the contributions can be ignored in determining the present value of these benefits.

For distributions made after the Department of Labor adopts final regulations implementing rules on fiduciary responsibilities relating to this provision, a plan must provide for the automatic rollover of any distribution of more than $1,000 to an IRA under this provision, unless the participant chooses otherwise. The plan administrator must notify the participant in writing that the distribution can be transferred to another IRA.

Plan Amendments To Conform to the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)

Generally, master and prototype plans are amended by sponsoring organizations. However, you may need to request a determination letter regarding a master or prototype plan you maintain that is a nonstandardized plan if you make changes to adopt some provisions enacted by EGTRRA. Your request should be made on the appropriate form (generally Form 5300, *Application for Determination for Employee Benefit Plan,* or Form 5307, *Application for Determination for Adopters of Master or Prototype, Regional Prototype or Volume Submitter Plans).* The request should be filed with Form 8717, *User Fee for Employee Plan Determination Letter Request,* and the appropriate user fee if the fee applies (see *User Fee,* later).

User Fee

The user fee for requesting a determination letter does not apply to certain requests made after 2001 by an eligible employer. An eligible employer is one who has 100 or fewer employees with at least one employee who is not highly compensated participating in a qualified plan. For more information, see *User fee* under *Setting Up a Qualified Plan* in chapter 4 of Publication 560, *Retirement Plans for Small Business.*

Simplified Employee Pensions (SEPs)

Deduction Limit Increased

For plan years beginning after 2001, the maximum deduction for contributions to a SEP increases from 15% to 25% of the compensation paid or accrued during the year to your eligible employees participating in the plan.

Elective Deferrals (SARSEPs) Increased

For tax years beginning after 2001, the limit on elective deferrals for participants in SARSEPs will increase, and participants who are age 50 or over at the end of the plan year may be able to make catch-up contributions. For information about the new limit and catch-up contributions, see *Elective Deferrals (401(k) Plans)* under *Qualified Plans,* earlier.

SIMPLE Plans

Salary reduction contributions. The limit on salary reduction contributions to a SIMPLE plan increases after 2001. The limit for 2002 and later years is as follows.

Year	Limit
2002	$ 7,000
2003	8,000
2004	9,000
2005 and later years	10,000

Note. The $10,000 limit is subject to adjustment after 2005 for cost-of-living increases.

Catch-up contributions. For tax years beginning after 2001, a SIMPLE plan can permit participants who are age 50 or over at the end of the plan year to make catch-up contributions. The catch-up contribution limit for 2002 and later years is as follows.

Year	Catch-Up Limit
2002	$ 500
2003	1,000
2004	1,500
2005	2,000
2006 and later years	2,500

Note. The $2,500 limit is subject to adjustment after 2006 for cost-of-living increases.

The catch-up contribution a participant can make for a year cannot exceed the lesser of the following amounts.

- The catch-up contribution limit.
- The excess of the participant's compensation over the elective deferrals that are not catch-up contributions.

403(b) Plans

Recent legislation has made several changes to the way you determine the maximum amount that can be contributed to your 403(b) account. See Publication 571, *Tax-Sheltered Annuity Plans (403(b) Plans) For Employees of Public Schools and Certain Tax-Exempt Organizations*, for more information about 403(b) plans.

Changes in figuring your maximum amount contributable (MAC). In years prior to 2002, the maximum amount contributable (MAC) to a 403(b) plan generally is the least of:

- The maximum exclusion allowance (MEA),
- The limit on annual additions, and
- The limit on elective deferrals.

The MEA has been repealed. Therefore, MAC for years beginning after 2001 is the lesser of the limit on annual additions or the limit on elective deferrals.

Church employees. Generally, for years prior to 2002, MAC for church employees would be figured as indicated above. However, certain church employees could use a minimum exclusion allowance instead of MEA to figure MAC. For years after 2001, the minimum exclusion allowance has been repealed. Therefore MAC for church employees for years beginning after 2001 is the lesser of the limit on annual additions or the limit on elective deferrals.

Changes to the limit on annual additions. For years beginning after 2001, the alternative limits on annual additions have been repealed. Therefore, beginning in 2002, you cannot use any of the following to figure your limit on annual additions.

- The year of separation from service limit.
- The any year limit.
- The overall limit.

Increased limit on annual additions. Beginning in 2002, the limit on annual additions has increased to the lesser of $40,000 or your includible compensation for your most recent year of service. For 2001, the limit on annual additions was the lesser of $35,000 or 25% of your compensation.

Includible compensation after termination. Beginning in 2002, your includible compensation for your most recent year of service will not include money received 5 years after termination of service with your employer.

Includible compensation for foreign missionaries. Beginning in 2002, your includible compensation for your most recent year of service does not include contributions made by the church during the year to your 403(b) account.

Increase in the limit on elective deferrals. For 2002, the limit on elective deferrals has been increased from $10,500 to $11,000. The limit on elective deferrals will increase by $1,000 each year through 2006.

Catch-up contributions for persons age 50 or older. Beginning in 2002, if you are age 50 or older, you may be able to make additional catch-up contributions of up to $1,000 to your 403(b) account. The limit on catch-up contributions will increase each year by $1,000 through 2006.

Changes to the coordination rules between 403(b) plans and 457 plans. Beginning in 2002, if you contribute to both a 403(b) plan and a 457 plan in the same year, you do not reduce the maximum deferral limit of the 457 plan by the amount of contributions made to your 403(b) account. If you contribute to a 457 plan in 2002, see your plan administrator for contribution limits.

Direct trustee-to-trustee transfer. If you make a direct trustee-to-trustee transfer after 2001 from your governmental 403(b) account to a defined benefit governmental plan, the transferred amount is not includible in gross income if it is used to purchase permissive service credits or repay contributions and earnings that were previously refunded under a forfeiture of service credit under another plan maintained by a state or local government employer within the same state.

Rollover options. Effective for distributions after 2001, you can roll over, tax free, money and other property that would otherwise be taxable from an eligible retirement plan to a 403(b) plan.

Additionally, you can roll over, tax free, money and other property that would otherwise be taxable from a 403(b) plan to an eligible retirement plan.

Section 457 Deferred Compensation Plans

Limit on elective deferrals. Beginning in 2002, the special limit on elective deferrals for section 457 plans no longer applies. Deferrals under these plans are subject to the general limit for elective deferrals ($11,000 for 2002). The special catch-up limit in the last 3 years before retirement is twice the general limit amount. Also, beginning in 2002, deferrals under section 457 plans are no longer coordinated with other plans in applying the deferral limit. For more information on section 457 plan elective defer-

rals, see *Retirement Plan Contributions* in Publication 525, *Taxable and Nontaxable Income.*

Qualified domestic relations order (QDRO). Beginning in 2002, if you receive a distribution or payment under a QDRO from an eligible state or local government section 457 plan in which your spouse or former spouse is a participant, you generally must pay the tax on it. For distributions or payments before 2002, the plan participant generally would have had to pay the tax. Under the new law, the plan participant still must pay the tax if the distribution or payment is made to a child or other dependent. For more information about QDROs, see the discussion under *General Information* in Publication 575, *Pension and Annuity Income.*

When to include deferred amounts in income. Beginning in 2002, amounts in eligible state or local government section 457 plans are generally deferred from tax until paid to you. Before 2002, these amounts generally became subject to tax when either paid or otherwise made available to you.

Rollovers. For distributions made after 2001, eligible state or local government section 457 plans are qualified retirement plans for rollover purposes. You may be able to roll over certain distributions to and from these plans. For more information about rollovers to and from qualified retirement plans, see *Rollovers* in Publication 575.

Tax on early distributions. The tax on early distributions may apply to a distribution made after 2001 from an eligible state or local government section 457 plan to the extent it is attributable to amounts rolled into the plan from another type of qualified retirement plan. For more information about the tax on early distributions, see *Tax on Early Distributions* in Publication 575.

Changes to the coordination rules between 403(b) plans and 457 plans. Beginning in 2002, if you contribute to both a 403(b) plan and a 457 plan in the same year, you do not reduce the maximum deferral limit of the 457 plan by the amount of contributions made to your 403(b) account. If you contribute to a 457 plan in 2002, see your plan administrator for contribution limits.

Excise Tax for Nondeductible (Excess) Contributions

For years beginning after 2001, when figuring the 10% excise tax, you can choose not to take into account as nondeductible contributions for any year contributions to a defined benefit plan that are not more than the full funding limit figured without considering the current liability limit. Apply the overall limits on deductible contributions first to contributions to defined contribution plans and then to contributions to defined benefit plans. If you use this new exception, you cannot also use the exception under section 4972(c)(6) of the Internal Revenue Code.

Earned Income of Members of Recognized Religious Sects

For years beginning after 2001, earned income for retirement plans includes amounts received for services by self-employed members of recognized religious sects opposed to social security benefits who are exempt from self-employment tax.

Rollovers

Eligible rollover distribution. You may be able to roll over the nontaxable part of a retirement plan distribution (such as your after-tax contributions) made after 2001 to another qualified retirement plan or traditional individual retirement account (IRA). The transfer must be made either through a direct rollover to a qualified plan that separately accounts for the taxable and nontaxable parts of the rollover or through a rollover to an IRA. For more information on eligible rollover distributions, see *Rollovers* in Publication 575, *Pension and Annuity Income.*

Hardship distributions not eligible for rollover. A hardship distribution made after 2001 from any retirement plan is not an eligible rollover distribution. For more information on eligible rollover distributions, see *Rollovers* in Publication 575, *Pension and Annuity Income.*

Time for making rollovers. You generally must complete the rollover of an eligible rollover distribution paid to you by the 60th day following the day on which you receive the distribution from your employer's plan. However, the 60-day period may be extended for distributions made after 2001 in certain cases of casualty, disaster, or other events beyond your reasonable control. For more information about rollovers, see Publication 575, *Pension and Annuity Income.*

Rollovers by surviving spouses. For distributions after 2001, an employee's surviving spouse who receives an eligible rollover distribution may roll it over into an eligible retirement plan, including an IRA, a qualified plan, a section 403(b) annuity, or a section 457 plan. A surviving spouse who received an eligible rollover distribution before 2002, could only roll it over into an IRA. For more information on rollovers, see Publication 575, *Pension and Annuity Income.*

Expanded written explanation to rollover distribution recipient. Before making an eligible rollover distribution, the administrator of a qualified retirement plan must provide you with a written explanation of various qualified retirement plan rollover rules. For most distributions made after 2001, the explanation must also tell you how the distribution rules of the plan you roll the distribution over to may differ from the rules that apply to the plan making the distribution in their restrictions and tax consequences. For more information about rollovers, see Publication 575, *Pension and Annuity Income.*

Later Changes

Elective Deferrals Treated as Roth Contributions

For plan years beginning after 2005, 401(k) and 403(b) plans can include a qualified Roth contribution program.

Deemed IRAs

For plan years beginning after 2002, a qualified retirement plan can maintain a separate account or annuity under the plan (a deemed IRA) to receive voluntary employee contributions. If the separate account or annuity otherwise meets the requirements of an IRA, it will only be subject to IRA rules. An employee's account can be treated as a traditional IRA or a Roth IRA.

4.

Estate and Gift Taxes

2001 Changes

Gifts to Spouses Who Are Not U.S. Citizens

The annual exclusion for gifts made to spouses who are not U.S. citizens is $106,000.

Increase in Generation Skipping Transfer (GST) Exemption

The generation-skipping transfer (GST) lifetime exemption increased by $30,000 to $1,060,000. The annual increase can only be allocated to transfers made during or after the year of the increase.

2002 Changes

Increased Estate Tax Applicable Exclusion Amount

The applicable exclusion amount is the amount on which the unified credit (applicable credit amount) is based. An estate tax return for a U.S. citizen or resident needs to be filed only if the gross estate exceeds this amount.

Year	Exclusion Amount
2002 and 2003	$1,000,000
2004 and 2005	1,500,000
2006, 2007, and 2008	2,000,000
2009	3,500,000

Increased Gift Tax Applicable Exclusion Amount

Beginning with gifts made in 2002, the applicable exclusion amount for lifetime gifts will be fixed at $1 million.

Increased Annual Exclusion for Gifts

The annual exclusion for gifts of present interests made to a donee during the calendar year is increased to $11,000.

The annual exclusion for gifts made to spouses who are not U.S. citizens is increased to $110,000.

Reduction of Maximum Estate and Gift Tax Rate

For estates of decedents dying, and gifts made, after 2001, the maximum rate for the estate tax and the gift tax will be reduced as follows.

Year	Maximum Tax Rate
2002	50%
2003	49%
2004	48%
2005	47%
2006	46%
2007, 2008, and 2009	45%

Repeal of Phaseout of Graduated Rates

For estates of decedents dying, and gifts made, after 2001, the benefit of the graduated rates will no longer be phased out for estates and gifts in excess of $10 million.

Reduction of Credit for State Death Taxes

For estates of decedents dying in 2002, the credit allowed for state death taxes will be limited to 75% of the amount that would otherwise have been allowed. For estates of decedents dying in 2003 and 2004, the credit will be limited to 50% and 25% respectively.

For estates of decedents dying after 2004, the state death tax credit will be replaced with a deduction for state death taxes.

Changes to Installment Payment Provisions

For estates of decedents dying after 2001, several rules applicable to qualifying for installment payments of estate tax have been changed.

- The allowable number of partners and shareholders in a closely held business is increased from 15 to 45.
- Stock in qualifying lending and finance businesses is treated as stock in an active trade or business company.
- The rules regarding non-readily-tradable stock and holding company stock are clarified.

Increase in Generation Skipping Transfer (GST) Exemption

The generation-skipping transfer (GST) lifetime exemption increased by $40,000 to $1,100,000. The annual increase can only be allocated to transfers made during or after the year of the increase.

Later Changes

Increased Generation Skipping Transfer (GST) Exemption

The lifetime exemption amount for generation-skipping transfers is increased as follows.

Year	GST Exemption
2004 and 2005	$1,500,000
2006, 2007, and 2008	2,000,000
2009	3,500,000

Repeal of QFOBI Deduction

The qualified family-owned business interest (QFOBI) deduction has been repealed beginning with the estates of decedents dying in 2004.

Repeal of Estate and Generation-Skipping Transfer Taxes

The estate and generation-skipping transfer taxes have been repealed for the estates of decedents dying and generation-skipping transfers made in 2010. New rules will go into effect at that time regarding the basis of assets transferred at death. The gift tax continues, but at reduced rates.

5.

Excise Taxes

2001 Changes

The following changes are effective for calendar quarters beginning after September 30, 2001. For more information, see Publication 510, *Excise Taxes for 2002*.

Filing Form 720

You must file Form 720, *Quarterly Federal Excise Tax Return*, by the last day of the month following the calendar quarter for which the return is made. The rule that allowed you to file by the last day of the second month following the calendar quarter for certain taxes has been eliminated.

Deposit Threshold

You do not have to deposit excise taxes for a calendar quarter if the net tax liability for the quarter is not more than $2,500. Previously, the amount was $2,000.

Deposit Due Dates

One deposit rule applies for all taxes that have to be deposited other than those deposited under the alternative method. You must deposit under the regular method by the 14th day following the semimonthly period. If the 14th day falls on a Saturday, Sunday, or legal holiday, you must deposit by the immediately ***preceding*** day that is not a Saturday, Sunday, or legal holiday. The deposit date for taxes deposited under the alternative method was not changed. The previous deposit rules (9-day rule, 14-day rule, and 30-day rule) have been eliminated.

Amount To Deposit and Safe Harbor Rules

Your deposit of taxes for a semimonthly period generally must be at least 95% of your net tax liability incurred during that period, unless the safe harbor rule applies. Previously, your deposit had to equal the amount of your net tax liability. The current liability safe harbor rule has been eliminated. However, for taxpayers depositing taxes that were in effect during the look-back quarter, the look-back quarter safe harbor rule still applies.

2002 Changes

For more information on these taxes, see Publication 510.

Air Transportation Taxes

For transportation beginning in 2002, the tax on transportation of persons by air is increased to $3.00 for each domestic segment. The percentage tax remains at 7.5%.

For amounts paid in 2002, the tax on the use of international air travel facilities will be $13.20 per person for flights that begin or end in the United States, or $6.60 per person for domestic segments that begin or end in Alaska or Hawaii (applies only to departures).

Luxury Tax

For 2002, the luxury tax on a passenger vehicle is reduced to 3% of the amount of the sales price that exceeds the base amount. The base amount for 2002 is $40,000.

6. Foreign Issues

2001 Change

Foreign Earned Income Exclusion Increased

For 2001, the maximum foreign earned income exclusion increases from $76,000 to $78,000.

See Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad,* to see whether you meet the requirements to exclude your foreign income.

2002 Change

Foreign Earned Income Exclusion Increased

For 2002, the maximum foreign earned income exclusion increases from $78,000 to $80,000.

7. How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Contacting your Taxpayer Advocate. If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate at **1–877–777–4778.**
- Call the IRS at **1–800–829–1040.**
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call **1–800–829–4059** if you are a TTY/TDD user.

For more information, see Publication 1546, *The Taxpayer Advocate Service of the IRS.*

Free tax services. To find out what services are available, get Publication 910, *Guide to Free Tax Services.* It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.

Personal computer. With your personal computer and modem, you can access the IRS on the Internet at **www.irs.gov**. While visiting our web site, you can:

- Find answers to questions you may have.
- Download forms and publications or search for forms and publications by topic or keyword.
- View forms that may be filled in electronically, print the completed form, and then save the form for recordkeeping.
- View Internal Revenue Bulletins published in the last few years.
- Search regulations and the Internal Revenue Code.
- Receive our electronic newsletters on hot tax issues and news.
- Get information on starting and operating a small business.

You can also reach us with your computer using File Transfer Protocol at **ftp.irs.gov.**

TaxFax Service. Using the phone attached to your fax machine, you can receive forms and instructions by calling **703–368–9694.** Follow the directions from the prompts. When you order forms, enter the catalog number for the form you need. The items you request will be faxed to you.

For help with transmission problems, call the FedWorld Help Desk at **703–487–4608.**

Phone. Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call **1–800–829–3676** to order current and prior year forms, instructions, and publications.
- *Asking tax questions.* Call the IRS with your tax questions at **1–800–829–1040.**
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call **1–800–829–4059** to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call **1–800–829–4477** to listen to pre-recorded messages covering various tax topics.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistor and does not keep a record of any taxpayer's name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistors objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers' opinions. Throughout this year, we will be surveying our customers for their opinions on our service.

Walk-in. You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county governments, credit unions, and office supply stores have an extensive collection of products available to print from a CD-ROM or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.

Mail. You can send your order for forms, instructions, and publications to the Distribution Center nearest to you and receive a response within 10 workdays after your request is received. Find the address that applies to your part of the country.

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  Central Area Distribution Center
  P.O. Box 8903
  Bloomington, IL 61702–8903
- **Eastern part of U.S. and foreign addresses:**
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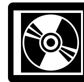
  Richmond, VA 23261–5074



CD-ROM. You can order IRS Publication 1796, *Federal Tax Products on CD-ROM,* and obtain:

- Current tax forms, instructions, and publications.
- Prior-year tax forms and instructions.
- Popular tax forms that may be filled in electronically, printed out for submission, and saved for recordkeeping.
- Internal Revenue Bulletins.

The CD-ROM can be purchased from National Technical Information Service (NTIS) by calling **1–877–233–6767** or on the Internet at **www.irs.gov.** The first release is available in mid-December and the final release is available in late January.

IRS Publication 3207, *Small Business Resource Guide,* is an interactive CD-ROM that contains information important to small businesses. It is available in mid-February. You can get one free copy by calling **1–800–829–3676** or visiting the IRS web site at **www.irs.gov.**

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