LOWER INCOME TAX RATES—FOR SOME

What's new. The centerpiece of the tax law is across-the-board rate cuts (see the table below), which, unlike much of the package, kick in this year. Congress also moved to eliminate the so-called marriage penalty by increasing the standard deduction for married couples and widening the 15% bracket, but full relief is eight years away.

Millions of Americans, though, will not get the tax cut they expect. The culprit is a parallel system of taxation called the alternative minimum tax (AMT), a flat 26% or 28% rate that was created to prevent the rich from avoiding taxes through excessive deductions. Because it was not indexed to inflation, it increasingly hits middle-income taxpayers. You calculate your AMT by adding certain breaks—such as deductible state taxes or personal exemptions—back into your income; you owe the standard tax bill or the AMT, whichever is higher. The new lower tax rates increase the odds that your AMT will be higher, and Congress provided only temporary relief. For the next four years, you can exempt more write-offs from the AMT calculation. But in 2005, when that relief ends, the number of Americans subject to the AMT will more than double.

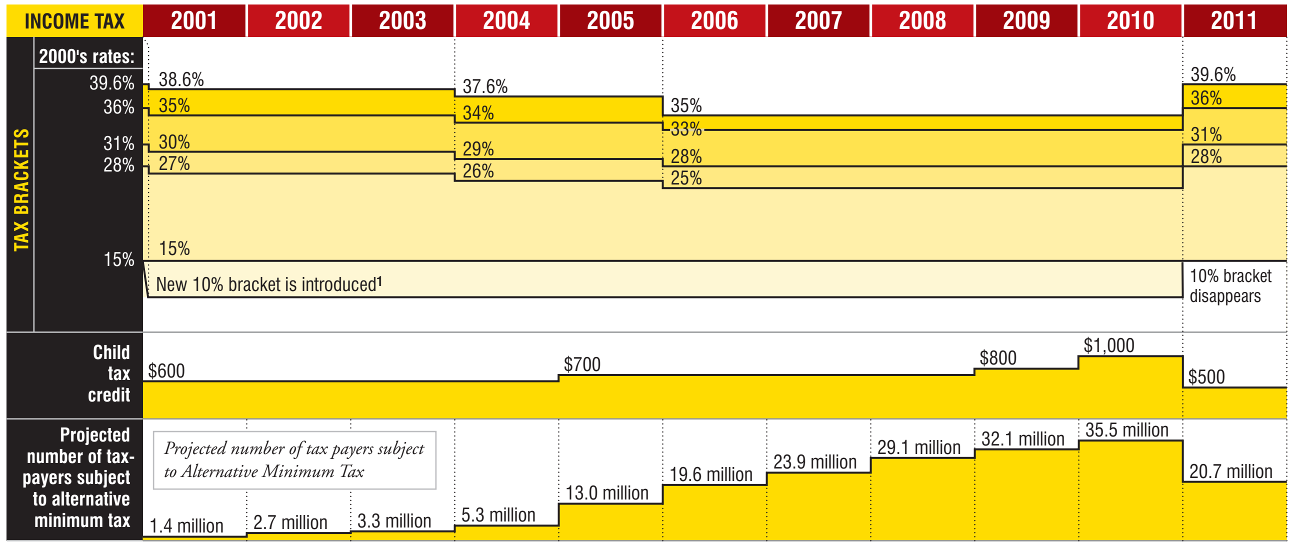
the AMT, according to Martin Nissenbaum, national director of personal income tax planning at Ernst & Young.

Either sit down with a planner or accountant or run the numbers online, using the TurboTax Tax Relief Estimator (www.quicken.com/taxes), which will give you a rough idea of your tax bill and AMT liability through 2010. If

35.5 MILLION TAXPAYERS COULD BE SUBJECT TO THE ALTERNATIVE MINIMUM TAX IN 2010, TWICE AS MANY AS WOULD HAVE PAID IT UNDER THE OLD TAX RATES.

What to do now. Even if you've never paid the AMT, it's worth calculating whether you might have to now. The most vulnerable taxpayers are those who have large families or pay hefty state and local taxes, and investors with substantial capital gains or incentive stock options. This year, a couple with a $100,000 adjusted gross income (AGI) who claim adjustments exceeding $30,731 will pay you expect to owe the AMT this year, hold off on discretionary deductions, such as extra local tax payments, and accelerate income if you can. If the AMT isn't a threat, your strategy should be the opposite: Claim deductions now and push off income until 2002 or later, when it will be taxed at a lower rate.

What to watch for. The chances that you'll owe AMT will increase annually. —L.H.G.



Notes: [1]From 2001 to 2007, 10% bracket applies to first $6,000 of income for singles, $12,000 for marrieds filing jointly and $10,000 for heads of households. From 2008 to 2010, applies to first $7,000 for singles, $14,000 for marrieds filing jointly and $10,000 for heads of households. **Sources:** Economic Growth and Tax Relief Reconciliation Act of 2001, CCH, Joint Committee on Taxation.

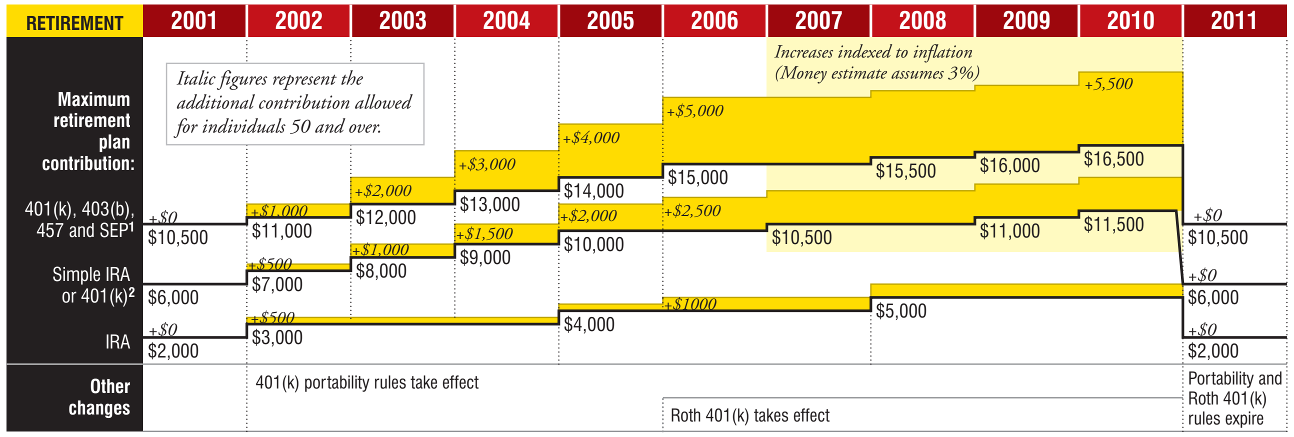
IRAs AND 401(k)s STRETCH THE LIMITS

What's new. Retirement investors will find a lot to like in the new tax law. Starting next year, you'll be able to contribute more money to a tax-sheltered plan—be it a 401(k) or a Simple IRA (see the table on page 94). If you're 50 or older, you'll be able to save even more—a boon to late starters who need to make up for lost time. (Congress did not raise the income limits for deductible or Roth IRAs, however; if you were not eligible to contribute before, you still aren't.) Other provisions of the law will give workers greater control over their money. From 2002 on you'll be able to roll most types of employer-sponsored plans into another plan or an IRA and to roll an IRA into your new plan—if your employer permits such moves. This is especially good news for government workers, who previously could not roll over 457 plans into anything other than another 457—not even into an IRA. Plus, all employer plans will be subject to faster vesting rules. Finally, the tax law makes it easier for small businesses to set up retirement plans, which should help the two out of three small business employees with no retirement coverage.

What to do now. Take full advantage of all tax-sheltered plans available to you. Under the old law, your annual 401(k), 403(b) or Keogh contributions—plus your employer's match and other pretax benefits such as profit sharing—could not total more than 25% of your compensation. The new max is the lesser of 100% of your pay or $40,000. "The new laws are great for two-worker families," says Karen Field, a senior manager at KPMG. "If one parent can put away as much as their salary in tax-deferred savings, the family can use that account for college tuition as well as retirement."

The new portability rules mean more flexibility in changing jobs. Retirees can benefit as well, since employer plans may not yet let you use the minimum distribution rules that took effect earlier this year for IRAs. If that's the case, you can probably roll your plan into an IRA so that you can stretch out withdrawals over a longer time.

What to watch for. In 2006, employers will be able to offer the choice of a regular 401(k) or a Roth 401(k), in which after-tax contributions grow tax-free and all withdrawals are tax-free. —J.F.



Notes: [1]Max. applies to salary reduction SEP only. [2]Deductible, nondeductible and Roth IRAs. **Sources:** Economic Growth and Tax Relief Reconciliation Act of 2001, American Benefits Council, CCH.

MORE HELP WITH COLLEGE COSTS

What's new. Whether you're saving for college or already paying tuition bills, the tax law delivers help—quickly. Starting next year, all withdrawals from state 529 college savings plans will be tax-free as long as the money is used for higher education. (Right now, earnings grow tax-free but are taxed at the student's rate when withdrawn, which is usually 15%.) You'll be able to invest $2,000 a year per child in an Education IRA—quadruple the current limit—and put the money toward the cost of kindergarten through high school, not just college. In addition, you'll be able to fund both tax-sheltered accounts for the same student in the same year penalty-free.

What to do now if you're saving for school. Because the law hikes the income limits for married couples who want to fund Education IRAs, more parents will face the dilemma of whether to fund an IRA or a 529. We think 529s have the edge, especially if you live in a high-tax state whose plan offers generous tax perks, such as New York and Michigan. You can salt away more money (up to $250,000 in some states) in funds run by seasoned managers such as Fidelity and TIAA-CREF, with no income limits. Plus, rolling one plan into another is now easier. Yes, the tax-free withdrawals sunset in 2011, but this is one reform Congress will likely make permanent. For a complete list of 529s, go to www.money.com. One exception: Education IRAs are better if you might use them to pay for elementary and secondary schools.

What to do now if you're paying for college. Next year, you'll be able to take tax-free withdrawals from an Education IRA or 529 *and* claim a HOPE credit (up to $1,500) or a lifetime learning credit (up to $1,000) if you meet the income cutoffs. The caveat: You can't take a credit for expenses paid for with tax-free earnings from an IRA or 529 plan, so careful record keeping is a must.

Nor will you be able to claim either credit if you take the new college costs deduction for the same student in the same year (see the table at the top of page 96). If you face that choice—a possibility for a couple with an AGI under $100,000—calculate both options. A credit is generally more valuable, but taxpayers who qualify for just a partial credit may come out ahead with the deduction, which will be in effect for four years, starting in 2002.

What to do now if you're paying off loans. You are more likely to be able to deduct up to $2,500 in student-loan interest in 2002 because the income cutoffs will be higher, and eligibility will extend for the life of the loan, not just the first 60 months of repayment. —L.H.G.

43 STATES HAVE 529 COLLEGE SAVINGS PLANS UP AND RUNNING OR DUE TO OPEN BY YEAR-END. TAX REFORM WILL MAKE INVESTING IN ONE EVEN MORE ATTRACTIVE.