

# New Tax Changes to Consider

**The Economic Growth and Tax Relief Reconciliation Act of 2001 has been heralded as the biggest tax cut since 1981.**

However, most of the tax changes are being phased in gradually, or do not take effect for several years. Here are some of the major changes you can expect:

## Individual Income Tax Reductions

A new 10% bracket for the first \$6000 of income for singles and \$12,000 for married couples is effective for 2001. The other four brackets' tax rates will be gradually reduced over 6 years. For 2001, the top four brackets are reduced to half a percentage point to 27.5%, 30.5%, 35.5% and 39.1%.

## Estate Tax Changes

Estate taxes were one of the most controversial parts of the tax debate. The end result was a very unusual plan for reducing estate taxes over time, then eliminating them and reinstating them. For most individuals and families, the changes are good news and should probably prompt a review of estate plans to make sure any needed changes are made to take advantage of the changing rules.

## Estate Tax Rates/Exemption Under The 2001 Tax Act

YEAR	ESTATE EXEMPTION	HIGHEST TAX RATE
2001 (Current)	\$675,000	55%
2002	\$1,000,000	50%
2003	\$1,000,000	49%
2004	\$1,500,000	48%
2005	\$1,500,000	47%
2006	\$2,000,000	46%
2007-2009	\$2,000,000	45%
2010 (N/A - tax repealed)		
2011 (Reverts to Current)	\$675,000	55%

## Retirement Planning Provisions

There are many changes that will make it easier for millions of Americans to more effectively accumulate larger amounts of money for their retirement. In 2002, the annual contribution limit for IRAs is being increased to \$3000. There are additional increases in subsequent years. The law also introduces a "catch-up provision" for individuals over 50 to make additional contributions. For 2001, the "catch-up" limit is \$500. There are also increased limits for 401(k) plan contributions starting in 2002 and a "catch-up" provision starting in 2001.

## Alternative Minimum Tax Issues

The original alternative minimum tax (AMT) was meant to ensure that individuals with substantial income were not avoiding taxes by using various tax reduction tools, techniques and shelters. The number of individuals that may be subject to this tax will grow as a result of the new tax laws. The way the AMT works is complex. Items such as stock options, large income or property tax deductions and income levels above \$150,000 may subject you to this tax.

## What Should Individuals Do Now?

Generally, there are a few specific actions individuals should take as a result of the new tax law. You may want to review your withholding and estimated tax to ensure you are not allowing the government to hold too much of your money. Investigate whether you should consider the "catch-up" opportunities with your IRA or 401(k) plan. You may want to review your estate plan and look at the various ways to save for college expenses. Finally, you may also want to talk to your tax advisor about the alternative minimum tax.



# Develop an Investment Strategy

## with Asset Allocation

How you divide your investment portfolio among stock, bond and cash investments is called asset allocation. It can serve as a logical starting point for your investment strategy.

### Evaluating Risk Tolerance

You should base your asset allocation on your time horizon and risk tolerance. First look at the chart below showing sample allocations based on age. Then review your risk tolerance by answering the questions that follow. There are no right or wrong answers.

AGE	STOCKS	BONDS	CASH
30s	65%	25%	10%
40s	60%	30%	10%
50s	50%	40%	10%
60s	30%	55%	15%

1. You have done your homework and bought \$5,000 of a stock you believe has very good growth potential. Two months after your purchase, the entire stock market declines and your stock is down 15%. Do you:
  - A. Sell all of it.
  - B. Sell half of it.
  - C. Hold it.
  - D. Buy more.
2. You work for a small and growing technology company. The company's owners are offering the employees the opportunity to buy stock in the company. They anticipate taking the company public sometime in the next three to five years. If you buy the stock, you will have to hold it until a public market exists, and it pays no dividends. Do you:
  - A. Buy none.
  - B. Buy one month's salary's worth.

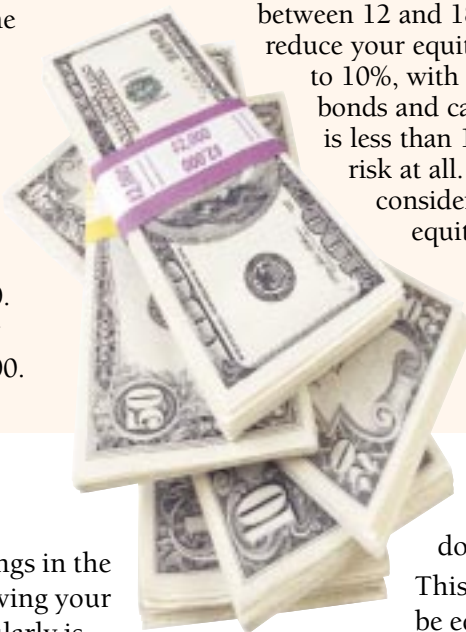
- C. Buy three month's salary's worth.
  - D. Borrow money and buy a year's salary's worth.
3. Which would you rather have done?
    - A. Invest in a money market fund currently paying about 4%.
    - B. Invest in an electric utility stock paying a 3% dividend with the potential for modest growth.
    - C. Invest in a portfolio of blue chip companies with a chance of earning average market returns.
    - D. Invest in two risky medical technology companies with a chance of significant gains or losses.
  4. You are on a TV game show. Which would you choose?
    - A. \$5,000 in cash.
    - B. A 50% chance of winning \$10,000.
    - C. A 20% chance of winning \$25,000.
    - D. A 10% chance of winning \$100,000.

Now let's go back and evaluate your answers. In each case, A answers are worth 2 points, B answers are worth 4 points, C answers are worth 6 points, and D answers are worth 8 points.

Add up the points for the answers you selected. The higher your score, the more willing you are to assume higher risk to earn higher returns. The midpoint of the possible scores is 20.

There is no exact way to modify the model asset allocations, but if your score is between 22 and 28, you should consider adding up to 10% to your equity allocation, with reductions primarily in bonds. If you are very risk-tolerant, with a score above 30, you might want to increase your equity exposure by up to 15%. But doing this is an aggressive move.

If you are a risk-avoider, with a score between 12 and 18, you could reduce your equity exposure by up to 10%, with increases in bonds and cash. If your score is less than 12, you don't like risk at all. You should consider reducing your equity exposure by 15%.



### Periodic Reviews

Reviewing your portfolio on a periodic basis to make sure it still matches your objectives makes sense. You may have added more funds to certain sectors, and your risk tolerance may have changed over time. Usually an annual review is enough. Rebalancing generally makes sense if your actual allocation has deviated more than 5% from your objective.

### Effect of a Volatile Market

With the recent swings in the stock market, reviewing your asset allocation regularly is prudent. When the market was going up in the late 1990s, many individuals' allocation became over-weighted with equities. If they did not take any action to bring the allocation back into balance, they probably ended up being hurt when

the market turned down.

This article is meant to be educational only.

Every individual must consider his/her specific situation when making investment decisions. For additional information, call Alaska USA Trust Company at 562-6544, or (888) 628-4567 toll-free.