DON'T PAY MORE TAX THAN YOU HAVE TO

There are many ways to reduce your income tax liability. But to find them, you must know not only what they are, but also which are best for you. And this is where many taxpayers fall short: They either fail to familiarize themselves with all the methods available, or they don't act in time to save all they might.

Good thing you picked up this guide. It provides an overview of the most common tax reduction strategies, including the tax law changes made by the Job Creation and Worker Assistance Act of 2002. Plus, pages 16 and 17 contain an At-a-Glance Tax Strategizer for quick reference to some fundamental techniques.

Of course, while we hope you find it helpful, this guide is still no substitute for a professional tax advisor. So please review this information, then consult a tax advisor for a more personalized discussion about how to minimize your taxes and maximize your financial well-being.

CONTENTS

TAXES ARE THE ONLY SURE THING FOR INVESTORS — 2

FAMILY "VALUE" CAN SAVE TAX DOLLARS — 7

BUSINESS AS USUAL SHOULDN'T APPLY TO YOUR TAXES — 11

AT-A-GLANCE TAX STRATEGIZER — 16

A BALMY RETIREMENT CALLS FOR BRIGHT IDEAS — 18

SAFEGUARD YOUR ESTATE WITH SOUND IDEAS AND DECISIVE ACTION — 23

OPPORTUNITIES CAN BE FOUND, NO MATTER WHERE YOU'RE BOUND — 28

The best way to use this guide is to identify those areas that may have the greatest effect on you or your business and discuss them with your tax advisor. The information in this guide is not intended for use without personalized professional assistance. If you need to discuss any issues in this guide, please contact your tax advisor. ©2002 07/02

Taxes Are the Only Sure Thing for Investors

You may forget about taxes while trying to succeed at investing. After all, so many other things — such as the economy and various companies' performances — can affect your investments. But come tax time, you'll be glad you planned ahead. Here are some key ways to do so.

Reduce turnover. Mutual funds with high turnover rates tend to repeatedly create capital gains. Long-term capital gains — gains on assets you have owned more than one year — are taxed at lower rates than regular income, typically 20% or sometimes even 10%. Thus, choosing funds that provide long-term gains could save you tax dollars.

Time capital gains and losses. Recognizing some losses when you already have recognized gains lets you offset them. Or, if you already have recognized a capital loss, you may want to recognize enough capital gain to absorb the loss before year end.

Be creative when selling assets. An installment sale allows you to defer capital gains on most assets other than publicly traded securities. You can reduce your overall tax burden by spreading the gain over several years as the proceeds are received. Or, if you invest in real property, consider a like-kind exchange. You may be able to defer gain for many years until you sell the newly acquired property.

Identify which shares you have sold. When possible, sell high-tax-basis shares to reduce gain or increase your loss and offset other gains. If you bought the same security at different times and prices, you must identify which shares you have sold when you file your tax return. If you hold actual stock certificates, you must surrender the appropriate ones.

Choosing mutual funds that provide long-term gains could save you tax dollars.

Avoid the dirty consequences of wash sales. An often overlooked provision known as the wash sale rule prevents you from taking a loss on a security if you buy an identical or significantly similar security (or option to buy a security) within 30 days before or after you sell it. If you violate this rule, you can realize a loss only when you sell the replacement security. Fortunately, there are several ways around the wash sale rule. For example, consider buying securities of a different company in the same industry or shares in a mutual fund that holds securities much like the one you sold. Alternatively, consider doubling up on your investment for a 31-day period or selling and waiting 31 days to repurchase.

Consider the tax impact of bonds. Although interest on U.S. government obligations is taxable on your federal return, such interest generally is exempt on your state and local returns. In contrast, interest on state and local government bonds is excludable on your federal return. If the state or local bonds were issued in your home state, interest also may be excludable on your return for that state. But corporate bond interest is fully taxable for federal and state purposes.

Tax Action Strategy

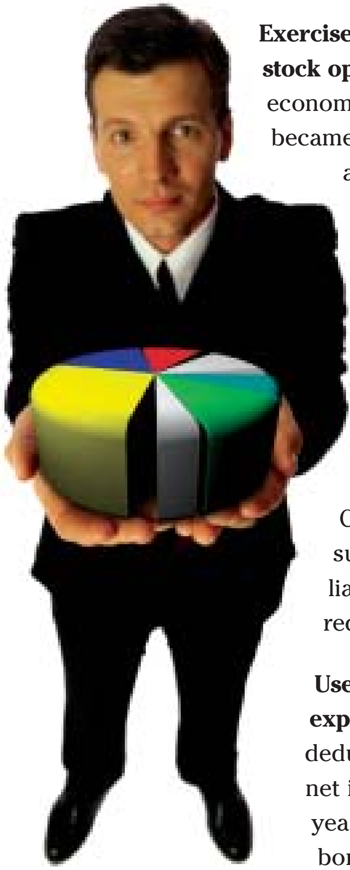
Turn Bad Debts Into Something Good

A failed investment is never a pleasant experience. But you can add a silver lining to this dark cloud by showing that a security or nonbusiness bad debt is fully worthless. To do so, you must prove that the security has absolutely no value.

Be careful: Even if it retains a negligible value, you may not be able to claim it as worthless. One way to eliminate this remaining small value is to sell it through a bona fide sale to an unrelated party for a nominal amount. To take the loss in 2002, you must finalize the sale before year end.

Swap your bonds. With a bond swap, you sell a bond, take a capital loss and then immediately buy another bond of similar quality from a different issuer. The wash sale rule does not apply to such a transaction, because the bonds are not substantially identical. Thus, you achieve a tax loss with virtually no change in economic position.

Beware of phantom income. Phantom income originates from investments that generate annual interest — even those that don't annually pay you this interest — such as a bond (except a U.S. savings bond) with original issue discount (OID), where you receive the "interest" as the bond rises toward its maturity price. The IRS contends you earn a portion of that interest annually and expects you to pay taxes on that interest. So, these investments may be best suited for tax-deferred vehicles such as IRAs and Keogh plans, or investors with other cash flow to absorb these taxes.



Exercise sound judgment with stock options. During last decade's economic boom, stock options became a common means of attracting new employees and compensating key executives. But in today's more unpredictable times, this perk's value has also become less certain. Thus, think carefully before exercising (or postponing exercise of) your option to sell or hold your shares. Complicated tax rules may substantially add to your tax liability if you act hastily — or reduce it if you plan properly.

Use the investment interest expense deduction. You can deduct the interest — up to your net investment income for the year — on any money you borrow to buy or carry taxable investments. But you can't include long-term capital gains in your net investment income for investment interest deduction purposes without waiving the favorable 20% rate and subjecting your gains to your higher ordinary income tax rate.

Maintain a constant awareness of your portfolio. For instance, if you hold taxable bonds for the purpose of generating income, weigh the benefit of receiving current income at a high tax cost against the lost opportunity for tax-deferred capital appreciation through other investment opportunities, such as equities.

Family "Value" Can Save Tax Dollars

Families don't just have "values," they also have "value." In other words, the fact you're raising children or saving for their education can lead to substantial tax savings. Let's look at how you can reap these benefits. (Some of these tips also may help students themselves.)

Shift income to children. In 2002, you and your spouse together can gift up to $22,000 of assets annually free of federal gift tax to each of your children. For children under age 14, unearned income beyond $1,500 will be taxed at your marginal rate — so the benefit of shifting income to them is limited. But for children ages 14 and older, all of their income (earned and unearned) will be taxed at their own marginal rates.

Start your child's tax-smart savings with a Roth IRA. Roth IRAs are perfect for teenagers in low tax brackets with many years to let their accounts grow tax free. The dollar limit for minors is the same as for adults: the lesser of $3,000 or 100% of earned income from a legitimate job reported on their tax returns. (This amount will rise in 2005 and again in 2008 — see Chart 2 on page 19.)

Take advantage of tax credits. You may be able to claim the $600 Child credit for each child under 17. And you may also be eligible for the Dependent Care credit. Note, too, that your alternative minimum tax (AMT) liability no longer reduces either of these credits. If you adopt, the Adoption credit and the exclusion from income for employer-provided adoption assistance now include the ability to take the credit against the AMT. The maximum Adoption credit and income exclusion increase to $10,000 per eligible child, and the bottom of the income phaseout range increases to $150,000 of modified adjusted gross income (AGI). But remember that these credits include restrictions and may phase out if your income is above a certain level.

Teach yourself about education credits. When those kids hit college, you may be able to claim a Hope credit for the first two years of postsecondary education. For qualified tuition and related expenses required for enrollment on at least a half-time basis, the maximum credit is $1,500 per student annually. (This amount is now adjusted for inflation.) Similarly, you or your children may be eligible for the Lifetime Learning credit of up to $1,000 per taxpayer for an unlimited number of years of postsecondary, graduate and certain other education expenses. If your child pays for his or her own tuition and you don't claim him or her as a

Chart 1
Child Credit Increases

Year	Credit per Child
2001 – 2004	$600
2005 – 2008	$700
2009	$800
2010	$1,000

Source: U.S. Internal Revenue Code

dependent, your child may be able to claim the Hope or Lifetime Learning credit on his or her return.

Grab education-expense deductions. Speaking of college, you may be able to deduct above the line a portion of qualified higher education expenses. The expenses are defined the same as for the Hope credit. In 2002 and 2003, taxpayers with AGIs not exceeding $65,000 for singles and $130,000 for joint filers will be eligible for a maximum annual deduction of $3,000. Further, you may exclude from income qualified employer-provided education assistance, which, beginning this year, also applies to graduate courses.

Consider a Section 529 plan. Also known as qualified tuition programs, these plans enable parents or grandparents to either secure current tuition rates with a prepaid tuition program or create tax-free savings accounts to fund college expenses. These plans can have considerable income tax advantages. Your contribution may qualify for the $11,000 annual gift tax exclusion ($22,000 for joint gifts by married couples). In fact, you can elect to use annual exclusions for the next five years all at once (for example, a $55,000 contribution or a $110,000 joint gift).

Tax Action Strategy

Cover More Education Costs With Coverdell ESAs

Previously known as education IRAs, Coverdell education savings accounts (ESAs) offer some key advantages. With certain income limitations, in 2002 you can contribute $2,000 (up from $500) annually to these plans to benefit a child under 18. The contribution is not deductible, but earnings will be distributed tax-free if used to pay for the beneficiary's post-secondary education expenses.

Beginning this year, you also can use the funds for elementary and secondary school expenses. And you may claim the Hope or Lifetime Learning credit as well as exclude from gross income Coverdell ESA distributions as long as you don't use the funds to pay the same expenses for which you claim the credit. The deadline for contributions is the due date of the income tax return for the year of contributions — April 15.

Distributions used to pay qualified higher education expenses will be income tax-free. This year, the definition of "qualified tuition program" has expanded to include certain prepaid tuition programs established and maintained by eligible private education institutions.

Deduct student loan interest. You may be able to deduct up to $2,500 of interest above the line. This year, the first-60-months rule is gone and AGI phaseout ranges have risen. They are now $50,000 to $65,000 for single filers and $100,000 to $130,000 for joint filers, and they will be adjusted annually for inflation.

Business as Usual Shouldn't Apply To Your Taxes

Most business owners would probably agree that 2002 was, at the very least, a challenging year. Well, one way to warm yourself against this chilly economic breeze is effective tax planning. Here are some tips on how to lower your business costs by keeping more money for yourself and giving less to Uncle Sam.

Consider business structure. Businesses may operate under a variety of structures, ranging from sole proprietorship to C corporation. Income taxation and owner liability are the main factors that differentiate the structures, but there are other factors to consider as well. There may be tax consequences to changing business structures, so choosing the best one for your needs when you launch a new business is critical.

When possible, defer income. In potentially high-income years consider deferring some income to later years. For example, if your business uses cash method accounting, you can delay billing notices as you approach year end and pay as many expenses as possible. Or, if you use the accrual method, you can delay shipping products or delivering services until the new tax year. Of course, beware of the business risks of these types of strategies.

Make the most of deductions. Sole proprietorships often overpay taxes because of missed tax deductions. Review your tax strategies to avoid making the same mistake. Generally, ordinary and necessary expenses incurred while conducting your trade or business are deductible.

Claim the executive compensation deduction. A business is entitled to a deduction for reasonable compensation paid or incurred during the taxable year. Keep this deduction in mind when assessing your company's tax liability. Another effective strategy is using certain types of deferred compensation programs, including tax-advantaged qualified plans — such as pension, profit-sharing and 401(k) plans — and nonqualified plans that can be more creative.

Tax Action Strategy

Benefit From Tax Breaks for the Self-Employed

If you are self-employed, you can deduct 70% of your health insurance costs for yourself, your spouse and your dependents. This above-the-line deduction is limited to the income you've earned from your trade or business. You can also deduct above the line half of the self-employment tax you pay on your self-employment income. And you may be able to deduct home office expenses.

Write off bad debts. Business bad debts are treated as ordinary losses and can be deducted when either partially or wholly worthless. For individuals and certain other entities, the IRS may consider loans made to closely held corporations as investments and, if not repaid, reclassify them as nonbusiness bad debts, which are treated as short-term capital losses. Starting this year, you can now carry back net operating losses five years — that's three years longer than previously. This relief is retroactive, applying to losses your company may have incurred during the 2000-2001 fiscal year as well as, of course, those you may suffer in the future.

Deduct equipment purchases. It's often assumed that equipment with a useful life well beyond the taxable year must be capitalized. Though this is generally true, an exception exists in the form of a de minimis rule, which allows current deductions for minor expenditures as long as they clearly reflect income. You may also take a current deduction for equipment repairs and maintenance expenses.

Thanks to a new tax law, eligible companies can now write off an additional 30% in "bonus" depreciation for some equipment purchases.

Use the annual depreciation deduction. The IRS generally treats all newly acquired tangible assets other than real estate as being placed in service at the midpoint of the year. This gives you six months of depreciation in the first year. But if you made more than 40% of the year's asset purchases in the fourth quarter, you may be required to use the generally less favorable midquarter convention. Then again, thanks to a new tax law, eligible companies can now write off an additional 30% in "bonus" depreciation for equipment purchases and leasehold improvements made after Sept. 10, 2001, but before Sept. 11, 2004. Thus, your company can immediately write off 30% of a new asset's cost and recover the remaining 70% under regular depreciation schedules.

Take advantage of depreciation rules. Careful planning during the year can help you maximize the deduction in the year of purchase. You generally will want to use the Modified Accelerated Cost Recovery System (MACRS), instead of the straight-line method, to get a larger deduction in the early years of an asset's life. You can also benefit from the Section 179 expense election, which allows a current deduction for assets that otherwise would be subject to the normal depreciation rules.

Manage your inventory for tax savings. You must calculate the dollar amount of inventory you have at year end. The higher the cost of merchandise sold, the lower your taxable income will be, so the inventory method you choose can significantly affect your taxable income.

Maximize tax credits. They reduce a business's tax liability dollar-for-dollar. Credits available to businesses include the Welfare-to-Work credit, the Work Opportunity credit and the Research and Development credit.

Hire your kids. As the owner of an unincorporated business, you can hire your children, pay each child who is over 14 as much as $7,700 and deduct the sum in full — and they will pay zero federal taxes. The children must perform actual work for wages in line with what you would pay nonfamily employees. And for kids under 18, you won't even owe any Social Security or Medicare taxes.

At-a-Glance Tax Strategizer

TAX STRATEGY	HOW IT WORKS
Accelerate Or Defer Income	If you expect to be in a higher tax bracket nex accelerating income into the current year can s taxes because you will be taxed at a lower rate expect to be in a lower tax bracket next year, t opposite approach — deferring income to the year — can reduce your taxes. Even if your ma bracket remains the same, deferring income to year generally will be advantageous.
Maximize Above-the-Line Deductions	You can take above-the-line deductions — the adjustments that determine adjusted gross inc (AGI) — in addition to the standard deduction itemized deductions. And because AGI determ your eligibility for various deductions, exempti credits, this strategy can further reduce your ta
Maximize Itemized Deductions	Claiming itemized deductions will save you tax your total itemized deductions exceed the stan deduction. (For 2002, the standard deductions $4,700 for single, $6,900 for head of househo $7,850 for married filing jointly and $3,925 for married filing separately.) And, by bunching ce deductible expenses in one year, you may be to exceed the applicable floors.
Claim Every Possible Exemption	Similarly to deductions, exemptions reduce the of income you pay tax on, so the more exemp can claim, the lower your tax bill.
Make the Most of Tax Credits	While adjustments, deductions and exemption the amount of income subject to tax, credits ta dollars directly off your tax bill, so they are par valuable tax-savings tools.
Plan for the Alternative Minimum Tax (AMT)	If you're subject to the AMT, consider timing r of income and payment of deductible expense minimize liability. If you paid the AMT in a pas you may be able to claim a credit, depending which adjustments generated the AMT.

*When evaluating various tax strategies, keep in mind that limitations exist depen your unique situation. We can advise you on the best way to proceed.

	ITEMS TO CONSIDER*
xt year, save you e. If you then the following arginal o a later	Your gross income includes all forms of income received, such as from wages, salaries and tips; interest; dividends; profits and losses from a business; capital gains and losses (see page 3); rents, royalties, partnerships, S corporations and trusts; unemployment compensation; alimony; Social Security benefits; IRA and pension distributions (see page 21); and refunds of state and local income taxes.
e income come or mines ions and axes.	Possible adjustments include IRA, SEP, SIMPLE or Keogh plan contributions (see page 20); alimony paid; moving expenses; self-employment tax (see Tax Action Strategy on page 13); self-employed health insurance (see Tax Action Strategy on page 13); penalty on early withdrawal of savings; student loan interest (see page 10); and beginning in 2002, some higher education expenses (see page 9).
xes if ndard s are ld, r ertain able	Possible itemized deductions include medical expenses; interest expense (see page 6, page 29 and page 30); foreign, state and local income taxes, and state property taxes (see page 29); charitable contributions (see page 31); casualty and theft losses; gambling losses; and miscellaneous expenses such as unreimbursed employee expenses, tax preparation fees and investment expenses.
e amount tions you	For 2002, you are allowed a $3,000 exemption each for yourself, your spouse, your dependent children and other qualified dependents.
ns reduce ake rticularly	Possible tax credits include the Child, Adoption, and Dependent Care credits (see page 8); and the Hope and Lifetime Learning credits (see page 8).
eceipt es to t year, on nding on	You will be subject to the AMT if your AMT liability exceeds your regular tax liability. AMT liability is determined by adding various tax adjustments back to your taxable income and deducting an exemption depending on filing status: $35,750 for single and head of household, $49,000 for married filing jointly. Rates are 26% on the first $175,000 of AMT income and 28% for income over that amount.

A Balmy Retirement Calls for Bright Ideas

Thinking about retirement can be a scary thing. Fortunately, you have many ways to save for your golden years without incurring hefty taxes. In fact, recent laws not only lowered many tax rates, but also opened new opportunities to build up even more savings for retirement. Here are a few of the many ways to ensure you'll rest easy when the time comes.

Maximize contributions to employer-sponsored plans. You may be able to make pretax contributions to your 401(k) or 403(b) plan up to the legal limit — $11,000 for 2002. Plus, your employer may match some of your contributions — also pretax. And plan assets grow tax deferred. Similarly, under Savings Incentive Match Plans for Employees (SIMPLEs), you may be able to elect to have your

Chart 2

Retirement Plan Contribution Limit Increases

Year	401(k)s & 403(b)s	401(k)s & 403(b)s for Taxpayers 50 & Over
2001	$10,500	$10,500
2002	$11,000	$12,000
2003	$12,000	$14,000
2004	$13,000	$16,000
2005	$14,000	$18,000
2006	$15,000	$20,000
2007	$15,000	$20,000
2008	$15,000	$20,000

Year	Traditional & Roth IRAs	Traditional & Roth IRAs For Taxpayers 50 & Over
2001	$2,000	$2,000
2002	$3,000	$3,500
2003	$3,000	$3,500
2004	$3,000	$3,500
2005	$4,000	$4,500
2006	$4,000	$5,000
2007	$4,000	$5,000
2008	$5,000	$6,000

Year	SIMPLEs	SIMPLEs for Taxpayers 50 & Over
2001	$6,500	$6,500
2002	$7,000	$7,500
2003	$8,000	$9,000
2004	$9,000	$10,500
2005	$10,000	$12,000
2006	$10,000	$12,500
2007	$10,000	$12,500
2008	$10,000	$12,500

Source: U.S. Internal Revenue Code

employer contribute up to $7,000 of your salary rather than pay you cash. You exclude the contribution from income, and again assets grow tax deferred. Contribution limits for 401(k)s, 403(b)s and SIMPLEs will gradually rise over the rest of this decade. And starting this year, taxpayers age 50 and up can make additional “catch-up” contributions to all of these plans. (See Chart 2 on page 19.)

Contribute to a traditional IRA, Keogh or SEP. You may be able to take an above-the-line deduction for traditional IRA contributions up to $3,000 or 100% of earned income, whichever is less. Taxpayers age 50 and up can also make catch-up contributions. The contribution limit will continue to increase. (See Chart 2.) You may also be able to deduct contributions to a Keogh or Simplified Employee Pension (SEP). Earnings in all three plans accumulate tax deferred. This year, annual addition limits for defined contribution Keogh plans will increase to $40,000. The benefit limits for defined benefit Keogh plans go up from $140,000 to $160,000. And the limit on SEP contributions increases from $25,500 to $30,000.

Consider a Roth IRA. Like a traditional IRA, this may allow you to make annual contributions of the

Tax Action Strategy

Anticipate Inflation's Effect

If your retirement is many years in the future, considering how inflation will affect your retirement living expenses is especially important. After all, as measured by fluctuations in the U.S. Consumer Price Index, inflation averaged 4% annually throughout much of the latter 20th century. For best results, you must take into account two periods of inflation: the time you will be accumulating retirement funds and the estimated length of your retirement.

Here's an example: Assuming a rate of 4%, in 20 years, you would need $109,556 to make today's $50,000 purchases. In contrast, those same purchases in five years would cost only $60,833. The difference in these two figures speaks directly to the importance of anticipating inflation's effect on your retirement plan. Obviously, knowing exactly how much the cost of living will increase is impossible, but past inflation rates can help you generate a likely accurate estimate.

lesser of $3,000 (reduced by contributions to all your other IRAs annually) or your compensation for the year, plus catch-up contributions if you are age 50 or over. The contribution limits will continue to increase. (See Chart 2 on page 19.) You cannot deduct contributions, but you can take qualified distributions tax free.

Plan for retirement account withdrawals. With a few exceptions, withdrawals made before age 59½ are subject to a 10% penalty, but once you reach

New distribution rules generally enable beneficiaries to withdraw IRA balances over their life expectancies so funds can grow tax deferred longer.

70½, you must withdraw the minimum required amount or face a 50% penalty. In early 2001, extensive changes to the distribution rules for IRAs and other similar plans were announced. These rules were then slightly modified and finalized in early 2002. As a result, calculating the required minimum distribution is now easier. The rules also generally enable beneficiaries to withdraw IRA balances over their life expectancies so funds can grow tax deferred longer. And the rules enable your heirs to do a considerable amount of postdeath planning. Deciding whether to take distributions before 70½ or more than the minimum at that age depends on how much you receive from other income sources, your life expectancy and other factors. Generally, maximizing tax-deferred growth provides more savings if you can afford to leave the funds in the plan.

Create a lump-sum strategy. When you retire, you may receive a lump-sum distribution from your employer's retirement plan. Consider rolling over the distribution to an IRA within 60 days. Doing so will avoid current income tax while the assets continue to grow tax deferred.

Safeguard Your Estate With Sound Ideas And Decisive Action

Following the introduction of last year's big tax act, you may have heard much about the apparent demise of the estate tax. But even though it's scheduled to expire in 2010, the estate tax will return in 2011 if Congress doesn't extend its repeal. And in the meantime, estate planning's importance persists. Let's look at how you can protect the money you've spent a lifetime earning.

Consider exemptions and tax rates. During your life or at death, you can pass up to the exemption amount free of gift and estate taxes. If your taxable estate is equal to or less than the exemption and you haven't already used any of the exemption on lifetime gifts, no federal estate tax will be due when you die. But if your estate exceeds this amount, it will be subject to estate tax.

Beginning this year, the estate tax exemption is $1 million and gradually increases until it reaches $3.5 million in 2009 and disappears in 2010, when the estate and generation-skipping transfer (GST) taxes are repealed. Also, before being eliminated in 2010, the top estate tax rate will gradually decrease through 2007. (See Chart 3 on page 24.)

Chart 3

Transfer Tax Exemptions and Rates

Year	Gift Tax Exemption	Estate & GST Tax Exemption [1]
2001	$675,000	$675,000 [2]
2002	$1 million	$1 million [3]
2003	$1 million	$1 million [4]
2004	$1 million	$1.5 million
2005	$1 million	$1.5 million
2006	$1 million	$2 million
2007	$1 million	$2 million
2008	$1 million	$2 million
2009	$1 million	$3.5 million
2010	$1 million	(repealed)

Year	Highest Estate, GST & Gift Tax Rates
2001	55% [5]
2002	50%
2003	49%
2004	48%
2005	47%
2006	46%
2007	45%
2008	45%
2009	45%
2010	35% (gift tax only)

1 Less any gift tax exemption already used.

2 The GST tax exemption is $1.06 million.

3 The GST tax exemption is $1.1 million.

4 The GST tax exemption is adjusted for inflation.

5 The benefits of the graduated estate and gift tax rates and exemptions are phased out for estates/gifts over $10 million.

Year	Estate Tax on $2.5 Million	Estate Tax on $5 Million
2001	$805,250	$2,170,250
2002	$680,000	$1,930,000
2003	$680,000	$1,905,000
2004	$465,000	$1,665,000
2005	$460,000	$1,635,000
2006	$230,000	$1,380,000
2007	$225,000	$1,350,000
2008	$225,000	$1,350,000
2009	$0	$675,000
2010	$0	$0

Source: U.S. Internal Revenue Code

Chart 4

Gift and Estate Tax Rates

Taxable Estate (After Deductions)	2002 Tax	Marginal Tax Rate (Tax on Next Dollar)
$1,000,000 or less	$0	41%
$1,250,000	$102,500	43%
$1,500,000	$210,000	45%
$2,000,000	$435,000	49%
$2,500,000	$680,000	50%

Source: U.S. Internal Revenue Code

Make lifetime gifts. Gifts you make during your lifetime are subject to federal gift tax. The top gift tax rate will gradually decrease until it reaches 35% in 2010 — the same as the highest income tax rate. (See Chart 3.) The exemption has increased from $675,000 to $1 million this year, but it stays at that level through 2010 under current law. Fortunately, you can exclude gifts of up to $11,000 per recipient each year. This exclusion increases to $22,000 per recipient if your spouse joins in the gift.

To use the annual exclusion, the law requires donors give recipients a present interest in the property. This usually means the recipient must have complete access to the funds. To avoid this, consider a Crummey trust, where the gift will qualify for the annual exclusion (because of a temporary right of withdrawal) even though the recipient doesn't have complete access to the gifted assets.

Take advantage of the unlimited marital deduction. Your estate generally can deduct the value of all assets that pass in a qualified manner — either outright or in trust — from you to your spouse during your lifetime or at your death, provided your spouse is a U.S. citizen. But if your combined estates are more than the exemption amount, simply using the marital deduction to avoid taxes on the first spouse's death could result in needless tax liability on the surviving spouse's death.

Keep an eye on the GST tax. The GST tax was designed to limit an individual's ability to transfer wealth to successive generations without incurring a gift or estate tax at each generation. It is and will remain equal to the top estate tax rate. Fortunately, the GST tax exemption will increase beginning in 2004 until the GST tax is repealed in 2010. Gifts to skipped generations can qualify for the $11,000 annual gift tax exclusion under certain conditions.

Plan for family business interests. If you are a family business owner, transferring business ownership can preserve your business and accumulated wealth — if planned properly. For instance, consider tax breaks such as the family business exemption, estate tax deferral and valuation discounts. Or

Tax Action Strategy

Determine Which Property To Gift

Take into account both estate and income tax consequences and the economic aspects of any gifts you'd like to make. To minimize estate taxes, gift property with the greatest future appreciation potential. To minimize income taxes, gift property that hasn't appreciated significantly since you've owned it, because your basis in the property generally carries over to the recipient, who will owe taxes on any gain when he or she sells it.

While the estate tax is in effect, it may make sense to wait to transfer highly appreciated assets until your death, because the basis will be stepped up and the capital gains tax can be avoided. For property that has declined in value, your best bet is to sell the property to take advantage of the tax loss. You may then gift the sale proceeds.

protect yourself with Section 303 redemptions and well-structured buy-sell agreements. These strategies can be complex; contact your tax professional for help.

Create trusts. Using trusts in a gift or estate plan can provide significant tax savings while preserving some control over what happens to the transferred assets. Common arrangements include credit shelter trusts, qualified terminable interest property (QTIP) trusts, qualified personal residence trusts (QPRTs), grantor-retained annuity trusts (GRATs) and grantor-retained unitrusts (GRUTs).

Opportunities Can Be Found, No Matter Where You're Bound

One upside to the tax law's complexity is its abundance of opportunities. Regardless of your age, occupation or marital status, you have options for lowering your tax bill. Don't believe it? Well then, let's look at some of the wide variety of additional savings strategies available.

Avail yourself of the drop in overall tax rates. Last year, you probably heard much about the new tax rate reductions. These cuts will continue helping taxpayers and their families this year. For instance, a new 10% rate applies to a portion of income that was previously taxed at 15%: the first $12,000 for married couples filing jointly, $6,000 for

Chart 5

Regular Income Tax Rate Reductions

Year	28% Rate Reduced To	31% Rate Reduced To	36% Rate Reduced To	39.6% Rate Reduced To
2001	27.5%	30.5%	35.5%	39.1%
2002/03	27%	30%	35%	38.6%
2004/05	26%	29%	34%	37.6%
2006 +	25%	28%	33%	35%

Source: U.S. Internal Revenue Code

singles and $10,000 for heads of households. Other tax rates will gradually drop through 2006. (See Chart 5.)

Maximize home-related deductions. If you use a mortgage to finance your home, you likely can deduct related points or prepaid interest. But be careful if you refinance your mortgage — only the amount that does not exceed the current outstanding principal balance will qualify as mortgage debt, though the excess may qualify as home equity debt. And don't forget to deduct your property taxes.

Make the most of moving. Are you planning on selling your home and moving in the near future? If so, remember that every two years you can exclude up to $250,000 ($500,000 if you're married filing jointly) of the gain you realize on the sale or exchange of your principal residence as long as you meet certain tests.

Pay off nondeductible interest. You may be able to maximize your interest deduction by paying

Tax Action Strategy
Create a CRT

A charitable remainder trust (CRT) works similarly to a gift annuity. You create a trust during your life or by will at your death to pay, for a given period, income to you or beneficiaries you select. At the end of that period, the trust's remaining assets pass to one or more charitable organizations. Because you're making a partial charitable donation, you or your estate receives a deduction for a portion of the trust's value. Even with the 2010 estate tax repeal (see page 23), this will still be an attractive strategy because of the income tax advantages.

off nondeductible interest — such as that on credit cards or auto loans — with money from a deductible class such as a home equity loan. If you're paying off credit cards, you likely also will benefit by paying interest at much lower rates.

Benefit from rental rules. If you rent a portion of your home or vacation home for less than 15 days, you need not report the income. Converting your residence from personal to rental use may benefit you if you can sell it only at a loss. The loss on the sale of a personal residence is not deductible. But if you sell the home after converting it for rental use, the loss is deductible because it is now a business and not a personal asset. Additional rules apply.

Consider filing separately. When both spouses have substantial income, and one has significant itemized deductions that are subject to a floor, filing separately may provide an overall tax savings.

Maximize charitable giving. Donating cash or other assets to charity is a great way to do good while lowering your tax bill. Because charitable contributions are generally fully deductible, the more you donate to charity, the more tax benefit you receive — as long as your itemized deductions exceed the standard deduction. Or if you wish to give larger, more regular amounts, consider more sophisticated charitable vehicles such as private foundations and donor-advised funds.

Donate appreciated assets. You can take a charitable deduction equal to the current fair market value and avoid paying tax on the long-term capital gain you would incur if you sold the property. For instance, instead of giving cash, donate appreciated publicly traded securities you have held for more than one

Donating cash or other assets to charity is a great way to do good while lowering your taxes.

year. Along with getting a tax deduction for the securities' full fair market value, you'll steer clear of paying capital gains tax on the appreciation. Beware: The deduction amount is subject to tighter limitations than cash contributions.

Set up a gift annuity. With a gift annuity, you contribute an asset to a charity that agrees to make annual payments back to you (and/or another beneficiary) either for a specified number of years or — more typically — until death. You can take an income tax deduction for the value of the donated amount minus the present value of payments back to you or your family. If the charity sells the asset, neither you nor the charity must pay capital gains tax on the proceeds. But you will owe some tax when you receive payments. (For a similar strategy, see "Create a CRT" on page 30.)