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Taxpayer Relief Act of 1997

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The Taxpayer Relief Act of 1997 has recently been passed and one should be aware of its consequences when one sells a house, saves for retirement, does estate planning, chooses health insurance, sells stocks or goes to college, among others.

The new law has increased the exclusion amount in capital gains when selling a primary residence. It favors sellers of homes who have profits not exceeding the exclusion amount of $250,000 or $500,000. A couple who sells a house or apartment that has been the primary residence of at least one spouse for at least two of the last five years can exclude up to $500,000 in capital gains. On the other hand, a single person can exclude up to $250,000. The amount in excess of the exclusion amounts, after deducting costs (which should be fully documented) of home improvements, is subject to a tax rate of 20 percent.

If the primary residence is sold and one has lived there for less than two years, the exclusion amounts will not be applicable unless one sells the home under certain circumstances like having a new job, for health reasons or for other unforeseen circumstances that will have to be stipulated in regulations. Those who move for the above enumerated reasons get a pro rata exclusion. For instance, a couple who live in a house for a year, one-half of the two-year minimum, could obtain an exclusion of $250,000 in profits, which is one-half of the exclusion amount of $500,000. But as long as you have lived in your primary residence for at least two years, even if that home was not your primary residence when you sold it or at the time you bought it, the exclusion amount is available repeatedly.

The old law provided a lower exclusion amount of $125,000 to those over 55 years old. The old law also allowed sellers of homes to delay the payment of taxes on their profits if, within two years of the sale, he purchased a new home that at least, costs as much as the previous home sold. The new law does not require the seller to buy a new home in order to avail of the exclusion amount.

For those planning to appropriate money for retirement, the new law provides a new option called the Roth I.R.A. Under this option, contributions are not tax deductible but the income accumulates tax free provided that the account has been open for five years and the proceeds are used after the age of 59 or used for specific other purposes, (such as for some college expenses of the accounts owner, a spouse, a child or a grandchild, or up to $10,000 to buy a first home), in which case the distributions from the account are tax free. The income limits under this option is $150,000 in modified adjusted gross income for joint filers and $95,000 for single filers. The tax-advantaged contributions are limited to $2,000 a year, a limit similar to the traditional I.R.A.s.

The new law gradually raises the amount exempt from gift and estate taxes from a value of $600,000 estate to $625,000 next year, and $1 million by year 2006. The exemption for qualifying family businesses was raised to $1.3 million next year. It is very important to have existing wills and estate plans reviewed in the light of the new provisions.

Under the new law, the elderly have many health insurance options. They can enroll in health maintenance organizations, preferred provider organizations, which allow the elderly to go outside the network of select physicians for an extra charge or private fee-for-service health plans, which offer unlimited choice of doctors and hospitals provided they use their own money to supplement Federal Medicare money. They can also establish a medical savings account to pay routine medical bills and at the same time buy private insurance to cover calamitous expenses, while being subsidized by Federal money. Medicare beneficiaries can get out of H.M.O.s with a month's notice until year 2002, after which they will be allowed to shift only after remaining in an H.M.O. for nine months. Beneficiaries can have Medigap policies if they return to the fee-for-service Medicare program within 12 months of their first enlistment in a Medicare+Choice plan or if they move out of the service area of the particular health plan. Under the new law, the monthly premium is expected to reach $67 in year 2002 (currently $43.80 a month). Those with low incomes may get Federal help to pay the premiums. The Medicare coverage has also been expanded to include preventive health services, like mammograms, Pap smears, screening for cancer of the prostate and colon, and tests to detect osteoporosis in some women and the training, education and blood-testing strips for diabetics. Limits will be imposed however, on the elderly's share of bills for hospital outpatient services.

Those who sell their assets like stocks or bonds for profit will pay a capital gains tax of 20 percent (or 10 percent for those in the 15 percent tax bracket for ordinary income) if they have held or owned the asset for at least 18 months and one day. If the asset is held for less than this period but more than one year and sold on or after July 29 for profit, a tax of 15 percent is imposed if the seller is in the 15 percent tax bracket on ordinary income, and 28 percent otherwise. In addition, taxpayers who are in the 15 percent bracket in year 2001 who sell assets they have owned for at least 5 years will be subject to a capital gains rate of only 8 percent (instead of 10 percent). However, those in higher brackets can avail of the five-year break only for assets acquired in 2001 or later, in which case the 18 percent rate (instead of 20 percent) will be applicable to assets sold after 2006.

The new law also establishes educational savings accounts patterned on I.R.A.s. Contributions of $500 a child a year are not tax deductible but the income in the account accumulates tax free and distributions are tax free when utilized for undergraduate or graduate level tuition, room, board or books. If the money withdrawn is not used for college expenses, the amount is taxed at ordinary income-tax rates plus an additional 10 percent tax. The income limits under this option is similar to the Roth I.R.A. which is $150,000 in modified adjusted gross income for joint filers and $95,000 for single filers. The new law provides a credit of up to $1,500 for the first two years of college and up to $1,000 (this amount can reach $2,000 after 2002) for additional years of college, for families with incomes up to $80,000 per annum. The credit is partially available for families with income up to $100,000. One can avail of the credit or the educational I.R.A. and not both at the same time.

Furthermore, a deduction of interest paid on student loans is allowed for the first five years in which the loans are repaid. The limit on the amount of interest that you can deduct is $1,000 for next year, $1,500 in 1999, $2,000 in 2000 and $2,500 in 2001 which is fully available to single filers earning up to $40,000 (phase out by $55,000) and joint filers (phase out would be between $60,000 and $75,000).