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**FOR IMMEDIATE RELEASE**
**4/2/02**

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## Achieve Your Retirement Goals Earlier with Help from the Tax Relief Act of 2001

Benefit from new rules this year that allow larger contributions to retirement plans. Taking advantage of these changes will help ensure you don't leave extra money on the table for Uncle Sam and can help you achieve your retirement goals earlier. The Tax Relief Act of 2001 begins raising contribution limits in 2002 for most retirement plans that were established and mostly unchanged since the early 1980's. Most retirement plans have specific contribution dollar limits for several years (see the table below), but then become automatically indexed to inflation.

**NEW QRP CONTRIBUTION LIMITS**

| Plan | Age | Previous Limits | 2002 | 2005 | 2006 | 2008 | >2008 |
|---|---|---|---|---|---|---|---|
| **Traditional & Roth IRA** | *Under 50*<br>*50 or older* | $2000<br>$2000 | $3,000<br>*$3,500* | $4,000<br>*$4,500* | $4,000<br>*$5,000* | $5,000<br>*$6,000* | *Indexed to Inflation* |
| **SIMPLE** (*salary deferral*) | *Under 50*<br>*50 or older* | $6500<br>$6500 | $7,000<br>*$7,500* | $10,000<br>*$12,000* | *Indexed to Inflation* | *Indexed to Inflation* | *Indexed to Inflation* |
| **401K,403B, 457** (*salary deferral*) | *Under 50*<br>*50 or older* | $10,500<br>$10,500 | $11,000<br>*$12,000* | $14,000<br>*$18,000* | $15,000<br>*$20,000* | Indexed to inflation in increments of $500 | Indexed to inflation in increments of $500 |
| **Educational IRA ("Coverdell")** | NA | $500 | $2,000 | $2,000 | 2,000 | $2,000 | $2,000 |

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**Traditional IRA** and **Roth IRA** contribution limits rise with an extra “catch-up” amount allowed for investors age 50 or older.  A contribution to a **Roth IRA** requires minimum earned income equal to the contribution and maximum MAGI (Modified Adjusted Gross Income) of $110k for singles and $160k if you file jointly.  The Roth proceeds are tax-free for life but contributions are never deductible from current taxes.

Anyone with single or joint earned income under age 70½ can make a Traditional IRA contribution, but tax-deductibility depends on your MAGI level and if you are covered by your employer’s retirement plan.  If you are not covered by an employer retirement plan and are single, the IRA is fully deductible regardless of income.  If you are covered or file a joint return and your spouse is covered, then you must meet income limits in order to be able to deduct your contribution from current taxes.  You may contribute to both a Roth IRA and a Traditional IRA in the same year but cannot exceed the limits shown in the table for any combination of IRA contributions.  ***If you are not eligible to take a Traditional IRA deduction, or are in a very low tax bracket, the Roth IRA is generally the more attractive choice.  Tax-free is always better than tax-deferred.***

For the **self-employed** or those employed at smaller firms, SIMPLE IRA’s have higher contribution limits as well in 2002 and beyond.  The only qualification for a SIMPLE contribution is that employees have earned income, at a minimum, that matches their SIMPLE contribution.  On top of the salary deferral limits shown in the table, companies must provide a 1-3% match based on earned income up to the amount of the salary deferral.

Congress didn’t forget about larger **corporate** retirement plans.  Salary deferral for 401(k)’s, 403(b)’s and 457’s (before company match) starts to rise in 2002 and becomes automatically indexed to inflation by 2006.  There are also eased restrictions on rollovers from one corporate plan to another or to a Traditional IRA.  Another improvement is that *matching employer contributions now will vest in three years rather than five.*

**Students** are also included in the Tax Relief Act of 2001. Educational IRA's (called Coverdell Savings Plan) now have a $2,000 annual limit, with the contribution deadline extended to April 15th, like other IRA's, rather than December 31st. A Coverdell can be opened if you have a MAGI under

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$190,000 and *can now be used for primary and secondary education as well as college.* A Coverdell contribution can be made by the student's parents, grandparents, a corporation, or a non-profit organization, but is limited to a total of $2,000 per year per student. The Coverdell contribution is only tax-deductible for corporations (so those of you that are self-employed should funnel your contribution through your business) but withdrawals are tax-free if not exceeding actual educational expenses for that year.

State-sponsored 529 plans are for college only, but now the withdrawals, if used for education, are tax-free rather than taxed at the student's rate. There are no income limits to establish a 529, and contribution limits, while varying from state to state, are as high as six figures in some states. While not tax deductible, contributions can play an important role in estate planning and gifting strategies. However, unlike IRA's, the 529's are limited to that particular plan's investment choices.

The Tax Relief Act of 2001 has a little something for almost everyone, and starts to rectify some of the inflation-eroded contribution amounts that we have been limited to for almost twenty years. Investors shouldn't pass up the opportunity to fully fund their plans for more tax-deferred or tax-free savings and create more long-term wealth. A CPA can calculate your immediate tax savings and a Registered Investment Advisor can estimate how maximizing contributions to your plans can help you reach your retirement and education goals.

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