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Financial Connections
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Implications of the 1997 Tax Changes

Are you planning to send your kids to college, save for your retirement, change your stock portfolio, invest in rental property, sell your home, or develop an estate plan? If so, the Taxpayer Relief Act of 1997 probably has some good news for you.

Estate plans

Expect to hear more from advocates of living trusts. Living trusts are commonly used to enable married couples to divide their estate into two halves for estate tax purposes, helping each half to pass under the current taxable threshold of $600,000. This threshold will rise in increments from $625,000 in 1998 to $1 million by 2006.

If your estate is worth nowhere near $600,000 now, it may be in the future, or you may have some other reason for choosing a living trust. But don’t let yourself be pressured into getting a living trust when a simple will will do. The new higher tax threshold coupled with Hawaii’s recent probate reform should make trusts unnecessary for many.

Home sales

Selling your home to move to a less expensive region or a smaller home? The new tax bill makes it much less painful for most taxpayers to move, buy down, or delay the purchase of a replacement home indefinitely. And there is no need to worry or wait regarding the age-55-or-older, one-time-only requirement for excluding $125,000 in capital gains. The new exemption is $500,000 for joint filers and $250,000 for single filers. The exemption has no cumulative cap and may be claimed every two years. The new provisions mean that many divorcing spouses, widows and retirees won’t be hit with a big tax bill when they sell the family home. And they won’t have to rent, buy a smaller home, or delay their housing decision indefinitely. This is great news for these families.

Property and stock investments

Buying rental property has always afforded special advantages in terms of leveraged investing and deductions for depreciation and other costs. Now there will be added advantages in terms of lower taxes on capital gains and greater incentives to buy and sell rental property as an investment. The new tax rates include 20 percent on gains between the purchase and selling price and 25 percent on depreciation deductions. The previous rate was 28 percent on gains, which included depreciation deductions.

Trading stocks has always been inhibited by the impending tax bite on gains from sales. The new tax changes have lessened the tax bite on long-term capital gains from 28 percent to 20 percent in the higher tax bracket and from 15 percent to 10 percent in the lower bracket. The period distinguishing regular gains from long-term gains has also been changed from 12 months to 18 months for stocks sold after July 28, 1997.

Retirement savings

The biggest change is a new IRA option that begins in 1998. It will enable taxpayers to accumulate and withdraw principal and earnings tax-free for buying a first home or retirement. Contributions are nondeductible with respect to income tax, and the money must be left in the account for at least five years. Tax-free withdrawals may begin after five years for the purchase of a first home or after five years and age 59 1/2 for any other purpose.

College education

Starting next year, parents struggling to finance their children’s college or vocational education will be able to take advantage of a $1,500-a-year tax credit for the first two years of schooling. The credit applies only to qualified tuition expenses. Also, starting next year, parents may begin saving $500 per child per year in the new tax-free IRA option described above or withdraw funds without penalty from a regular IRA for higher education. Be aware that restrictions may apply regarding any of these tax changes. Further inquiry regarding the details of these changes is advised before making changes or taking actions that might appear to be indicated with respect to your personal situation.

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