WHAT'S NEW ON FORM 1040 FOR 2003

Tax season is just around the corner and IRS has already electronically released a number of final tax forms and schedules for the 2003 tax year, including Forms 1040, 1040A and 1040EZ, along with most of their schedules. The new forms, schedules and instructions reflect key provisions of the Jobs and Growth Tax Relief Reconciliation Act of 2003 ("2003 Act") and other legislation.

This Hot Topic highlights key changes on the 2003 Form 1040, its schedules and some related forms. Changes generally are listed in the order in which they appear on the return, schedule or form.

Form 1040 - U.S. Individual Income Tax Return

- **Tax rates reduced.**

  The tax rates have been retroactively reduced by the 2003 Act for all of 2003 as follows:

  1. For single individuals and married taxpayers filing separately, the 10% bracket applies to the first $7,000 of taxable income (to the first $14,000 of taxable income for married joint filers and qualifying surviving spouses);

  2. The 15% tax bracket for joint returns is widened; and

  3. The regular income tax rates above 15% are reduced to 25%, 28%, 33%, and 35%.

  The new rates are reflected in the Tax Table and the Tax Rate Schedules.

- **New filing locations.**

  Taxpayers may be mailing their 2003 returns to different service centers than in past years because IRS has changed the filing location for several areas. Envelopes included in tax packets mailed from IRS should reflect any change to the filing location, which also can be determined from the instructions to Form 1040.

- **Qualified dividends (Line 9b).**

  Dividends paid by most domestic and foreign corporations after Dec. 31, 2002, are eligible for the new maximum capital gains tax rate of 15% (5% in some cases). A taxpayer who has qualified dividends will have to use either Schedule D or the Qualified Dividends and Capital Gain Tax Worksheet, whichever applies, to figure his tax.

  Generally, qualified dividends are shown in Box 1b of the taxpayer's Forms 1099-DIV. Note, however, that some dividends may be reported as qualified dividends in Box 1b of Form 1099-DIV but are not qualified dividends. These include:

  - Dividends received as a nominee.

< Dividends received on any share of stock that was held for less than 61 days during the 120-day period that began 60 days before the ex-dividend date.

< Dividends attributable to periods totaling more than 366 days that were received on any share of preferred stock held for less than 91 days during the 180-day period that began 90 days before the ex-dividend date. Preferred dividends attributable to periods totaling less than 367 days are subject to the 61-day holding period rule above.

< Dividends on any share of stock to the extent that the taxpayer is under an obligation (including a short sale) to make related payments with respect to positions in substantially similar or related property.

< Payments in lieu of dividends, but only if the taxpayers knows or has reason to know that the payments are not qualified dividends.

■ **Capital gain or loss (Line 13).**

As discussed in greater detail in connection with Schedule D below, long-term capital gain other than 28% gain, such as gain on collectibles, and unrecaptured section 1250 gain, is taxed no higher than 5% or 15% (generally at 10% or 20%, for capital gains taken into account before May 6, 2003). A taxpayer who has capital gains will have to use either Schedule D or the Qualified Dividends and Capital Gain Tax Worksheet, whichever applies, to figure his tax.

■ **IRA deduction (Line 24).**

The AGI phase-out ranges for making deductible contributions to regular IRAs by taxpayers that are active participants in an employer-sponsored retirement plan are higher for 2003. The phase-out range is $60,000 to $70,000 for joint return filers and $40,000 to $50,000 for single taxpayers.

■ **Self-employed health insurance deduction (Line 29).**

A qualifying self-employed person (or a partner or a more-than-2%-shareholder of an S corporation) may deduct 100% of amounts paid for medical insurance.

■ **Standard deduction (Line 37).**

For 2003, the standard deduction is $4,750 for single filers, $4,750 for married persons filing separately, $9,500 for joint filers and qualifying widow(er)s, and $7,000 for heads of household.

< <u>Observation</u>: This figures reflect inflation adjustments and, for married persons, marriage penalty relief provided by the 2003 Act.

■ **Personal exemptions (Line 40).**

The exemption amount for 2003 is $3,050. Exemptions phase out if adjusted gross income exceeds: $139,500 for single filers, $104,625 for married persons filing separately, $209,250 for joint filers and qualifying widow(er)s, and $174,400 for heads of household.

- **Alternative minimum tax (Line 42).**

  The maximum AMT exemption amount for individuals is increased to $58,000 for married taxpayers filing jointly, to $29,000 for married individuals filing separately, and to $40,250 for unmarried individual

- **Credit for child and dependent care expenses (Line 45).**

  The maximum credit is 35% of employment-related expenses, and the maximum amount of employment-related expenses that may be used to compute the credit is $3,000 for one qualifying individual and $6,000 for two or more qualifying individuals.

- **Education credits. (Line 47).**

  Availability of the Hope credit and Lifetime Learning credit phases out ratably for taxpayers with modified AGI of $41,000 to $51,000 ($83,000 to $103,000 for joint return filers). The maximum Lifetime Learning credit is doubled to $2,000.

- **Child tax credit (Line 49).**

  The maximum child tax credit is increased from $600 to $1,000 per eligible child (the increase in the child tax credit amount was paid in advance during 2003 to many taxpayers).

  - Observation: A taxpayer must reduce his child tax credit(s) by any advance child tax payment received in 2003, as shown on Notice 1319 mailed from IRS. The calculation is done on a Child Tax Credit Worksheet.

  - Observation: A taxpayer who received an advance payment and doesn't have a qualifying child at the end of 2003 needn't pay it back.

- **Adoption credit (Line 50).**

  The maximum adoption credit is higher ($10,160) and phases out when modified AGI exceeds $152,390.

- **Self-employment tax (Line 55).**

  Maximum amount of self-employment income subject to FICA tax is $87,000. No ceiling on Medicare tax wage base.

- **2003 estimated tax payments and amount applied from 2002 return (Line 62).**

  For taxpayers whose adjusted gross income for 2002 was over $150,000, estimated tax underpayment penalty for 2003 is avoided if estimated tax payments for 2003 are at least equal to (1) 110% of the tax shown on the 2002 return, or (2) 90% of the tax shown on the

2003 return, whichever is less.

- **Earned income credit (Line 63).**

  The maximum earned income credit is higher and the AGI-based phase-out figures are revised.

- **Excess social security and RRTA tax withheld (Line 64).**

  The maximum Social Security (OASDI) tax for 2003 is $5,394 (computed on the first $87,000 of wages) for purposes of the credit for excess tax withheld.

- **Third party designee.**

  A third party designee can ask the IRS for copies of notices or transcripts related to a taxpayer's return. Also, the authorization can be revoked.

Schedule A-Itemized Deductions

- **Medical and dental expenses (Schedule A, Line 1).**

  These expenses include eye surgery to correct defective vision and procedures to facilitate pregnancy.

- **Unreimbursed employee business expenses (Schedule A, Line 20).**

  The standard mileage rate for business travel is 36 cents a mile.

- **Total itemized deductions (Schedule A, Line 28).**

  Adjusted gross income over $139,500 ($69,750 if married filing separately) triggers a reduction in itemized deductions.

Schedule B-Interest and Ordinary Dividends

- **Interest (Schedule B, Line 1).**

  Accrued interest on Series E U.S. savings bonds issued in '63 or in '73 generally is taxable.

  < Observation: That's because Series E bonds issued before Dec. '65 reach final maturity 40 years after their issue date and bonds issued after Nov. '65 reach final maturity after 30 years. Thus, bonds issued in '63 and '73 reached final maturity in 2003 so that all the accrued interest not previously taxed is taxable in 2003. However, if the bonds are exchanged for HH bonds (which are current-income bonds), the deferral continues until the HH bonds are cashed, reach final maturity, or are reissued in a reportable event.

- **Excludable interest on Series EE and I U.S. savings bonds (Schedule B, Line 3).**

The exclusion for education related savings bond interest phases out at higher income levels. For 2003, the phase-out begins at modified adjusted gross income above $58,500 ($87,750 on a joint return).

Schedule C-Profit or Loss from Business (Sole Proprietorship)

- **Reporting changes.**

  Contract labor is now reported on line 11 and bad debts are now reported in Part V.

- **Car and truck expenses (Schedule C, Line 10 and Schedule F, Line 12).**

  The standard mileage rate is 36 cents per mile for business travel.

Schedule D-Capital Gains and Losses

- **Rates reduced.**

  The 20% maximum tax rate on net capital gain (the excess of net long-term capital over net short-term capital loss) has been reduced to 15%, and the 10% rate has been reduced to 5%, for sales and other dispositions after May 5, 2003 (installment payments received after that date). The 25% rate on unrecaptured section 1250 gain and the 28% rate on section 1202 gain have not changed.

- **8% rate eliminated.**

  The 8% maximum capital gains tax rate for qualified 5-year gain has been eliminated for sales and other dispositions after May 5, 2003 (and installment payments received after that date). Instead, gain from these transactions will be taxed at the 5% maximum capital gains tax rate described above.

- **Figuring 28% rate gain.**

  Any 28% gain is now figured on a worksheet and entered on Schedule D, line 20.

- **Capital Loss Carryover Worksheet.**

  The Capital Loss Carryover Worksheet has been removed from the 2003 instructions for Schedule D. To figure a capital loss carryover to 2004,a taxpayer will use a worksheet in the 2004 instructions to Schedule D.

Schedule SE-Self-Employment Tax

- **Self-employment tax (Schedule SE, Section A, Line 5; Section B, Line 7).**

  The 12.4% social security tax applies to the first $87,000 of self-employment income. There is no ceiling on the Medicare tax wage base.

Form 2106-Employee Business Expenses

■ **Standard mileage rate (Form 2106, Line 22).**

The standard mileage rate is 36 cents per mile.

■ **Special depreciation allowance.**

The special depreciation allowance increases from 30% to 50% for most new business vehicles acquired after May 5, 2003. If the 50% allowance applies, a taxpayer may elect to use the 30% allowance or elect out entirely for any class of property.

■ **Limit on depreciation and expensing.**

The first-year limit on depreciation and the Code Sec. 179 deduction for most vehicles eligible for the 50% special allowance (including vehicles for the 30% allowance is elected) is increased to $10,710. If a taxpayer elects out of both the 30% and 50% allowances, this limit is $3,060. For light trucks and vans, the first-year limit is increased by $300 (regardless of whether the 30% or 50% special allowance applies).

Form 4562-Depreciation and Amortization

■ **Maximum Sec. 179 expense deduction (Form 4562, Line 1).**

The maximum regular expensing amount is $100,000 ($135,000 for qualified enterprise zone, renewal community, and Liberty zone property). This limit is reduced by the amount by which the cost of section 179 property placed in service during the year exceeds $400,000.

■ **Special depreciation allowance (Form 4562, Part II).**

An additional 30% or 50% first-year depreciation allowance applies to most new depreciable personal property placed in service during 2003, as well as some software.

■ **Listed property (Form 4562, Part V).**

First-year luxury auto limits for vehicles placed in service in 2003 are:

< $3,060 for autos, $3,360 for light trucks and vans if not eligible for bonus depreciation (or taxpayer elects out);

< $7,660 for autos and $7,960 for light trucks and vans eligible for 30% bonus depreciation (generally, acquired new after December 31, 2002, and before May 6, 2003); and

< $10,710 for autos and $11,010 for light trucks and vans eligible for 50% bonus depreciation (generally, acquired new after May 5, 2003, and before January 1, 2004).