

June 12, 2003

OVERVIEW OF TAX CHANGES IN THE JOBS AND GROWTH TAX RELIEF RECONCILIATION ACT OF 2003

As you probably know, Congress recently passed the "Jobs and Growth Tax Relief Reconciliation Act of 2003," which contains significant tax cuts for stockholders, individual taxpayers, couples and businesses. Here's what you need to know right now about this important new legislation. Please keep in mind, these are only highlights of the most important changes in the new law.

REDUCTIONS IN TAXES ON DIVIDENDS AND CAPITAL GAINS

An important component of the 2003 Jobs and Growth Act, particularly if you are an investor, is a reduction in the taxes on dividends and capital gains. These lower rates can mean considerable tax savings for taxpayers, although they are not permanent, since they will cease to apply after 2008, barring additional Congressional action to extend them. Here are more details regarding dividends and capital gains under the Act.

Under the 2003 Jobs and Growth Act, effective for sales and exchanges (and installment payments received) after May 5, 2003, and before Jan. 1, 2009, the 10% and 20% rates on adjusted net capital gain are reduced to 5% (zero in 2008) and 15% respectively, for both regular tax and the alternative minimum tax (AMT). The lower rates apply to sales of capital assets held more than one year. Because this 5% drop in the capital gains rate is more than the 3.6% drop in the top individual rate under the 2003 Jobs and Growth Act and the 2% drop in other individual rates, the advantage of long-term capital gains over other types of taxable income is even greater for high earners than it was before.

Note, however, there is no cut in the 28% capital gains rate affecting collectibles and certain small business stock and the 25% rate affecting gains representing depreciation claimed on MACRS realty. For dividends received in tax years beginning after 2002 and before 2009, dividends received by an individual shareholder from domestic corporations (or "qualified foreign corporations") are treated as adjusted net capital gain for purposes of applying the capital gain tax rates. In other words, the dividends are taxed at rates of 5% (zero in 2008) and 15% for both regular tax and AMT purposes. This results in substantial tax savings for dividend recipients.

ACCELERATION OF CERTAIN PREVIOUSLY ENACTED TAX BENEFITS AND REDUCTIONS FOR INDIVIDUALS

An important component of the 2003 Jobs and Growth Act speeds up previously enacted tax benefits and reductions that were scheduled to be phased in over the next several years. These acceleration provisions include:

< *Acceleration of 10% individual income tax rate bracket expansion.*

The expansion in the width of the 10% rate bracket for single and joint filers is accelerated from 2008 to 2003. Thus, under the 2003 Jobs and Growth Act, the 10% tax bracket for 2003 ends at \$14,000 (up from \$12,000) of taxable income for joint filers and \$7,000 (up from \$6,000) for single filers and marrieds filing separately, and for 2004, both these figures will be indexed for inflation. The endpoint of the 10% bracket for heads of household remains unchanged at \$12,000. From 2005 through 2007, the end point of the 10% bracket will revert to the \$12,000/\$6,000 levels (and under 2001 EGTRRA, will go up to \$14,000/\$7,000 for 2008 through 2010).

< *Acceleration of reduction in individual income tax rates.*

The 2003 Jobs and Growth Act change which will affect the widest number of taxpayers is an immediate reduction of the marginal tax brackets paid by all but the lowest earners. Under the change, the tax rates above 15% for 2003 and later years are 25%, 28%, 33%, and 35% (previously rates for 2003 above 15% were 27%, 30%, 35%, and 38.6%). These rate reductions were scheduled for 2006 under 2001 EGTRRA. After 2010, rates above 15% will revert to the pre-2001 EGTRRA levels (i.e., to 28%, 31%, 36%, and 39.6%).

< *Acceleration of marriage-penalty relief.*

The 2003 Jobs and Growth Act reduces so-called marriage penalties (i.e., tax-law provisions that force two-income couples to pay more in taxes each year merely because they are married). The basic standard deduction for joint returns will be double (\$9,500 for 2003) the basic standard deduction for single returns (under the Economic Growth and Tax Relief Reconciliation Act of 2001 (2001 EGTRRA), this wasn't scheduled to be fully phased in until 2009). However, for tax years beginning after 2004, a joint return filer's basic standard deduction will revert to pre-2003 Jobs and Growth Act levels (e.g., for 2005, to 174% of a single return filer's basic standard deduction). Furthermore, in 2003 and 2004, the end point of the 15% tax bracket for joint returns will be twice the end point of the 15% tax bracket for single returns (under 2001 EGTRRA, this wasn't scheduled to happen until 2008). In other words, for 2003, the 15% tax bracket for joint filers applies to taxable income over \$14,000 (up from \$12,000) but not over \$56,800 (up from \$47,450). However, for tax years beginning after 2004, the end point will, like the basic standard deduction amount, revert to pre-2003 Jobs and Growth Act (e.g., for 2005, 180% of the end point of the 15% tax bracket for single returns).

< *Acceleration of increase in child tax credit.*

For 2003, 2004 and 2005, the child tax credit will increase to \$1,000 per qualifying dependent child under 17 (up from the \$600 per qualifying child for 2003-2004 and \$700 for 2005 that was provided for under pre-2003 Jobs and Growth Act law), but after 2005 the child tax credit will fall back to \$700 for 2006-2008. What's more, for 2003, the increased amount of the child tax credit will be paid in advance beginning in mid-July over a period of three weeks. Thus, a typical qualifying family will receive an advance payment check for up to \$400 per qualifying child who is under age 17 as of the end of 2003. Note that the income limits related to the child tax credit are

unchanged by the 2003 Jobs and Growth Act, which means that the amount of the credit allowable is reduced or eliminated for taxpayers with adjusted gross income (AGI) over \$75,000 for singles and \$110,000 for married couples. However, taxpayers who didn't qualify in the past for the child tax credit because of AGI limitations may now qualify for a portion because of the increased credit (even though they won't get an advance payment).

< *Minimum Tax relief to individuals.*

The 2003 Jobs and Growth Act also includes some relief from the alternative minimum tax (AMT). For 2003 and 2004, the maximum AMT exemption for joint filers and surviving spouse is increased to \$58,000 (up from \$49,000 under pre-2003 Jobs and Growth Act law) and for unmarried taxpayers is increased to \$40,250. The limits will revert to \$45,000 and \$33,750 after 2004.

TAX CHANGES FOR BUSINESSES AND CORPORATIONS

The 2003 Jobs and Growth Act includes two temporary tax breaks designed to encourage immediate investments. Under the first of these breaks, small companies can expense up to \$100,000 in new equipment investments through 2005. Under a second provision, businesses can depreciate more of their assets sooner through 2004. Another change for corporations affects the estimated tax payment rules for 2003.

! Increased Asset Expensing Limitation

The 2003 Jobs and Growth Act vastly liberalizes the expensing election, which permits small businesses to expense (i.e., deduct immediately rather than depreciate over several years) a certain amount of the cost of tangible depreciable personal property purchased and placed in service during the tax year in an active trade or business. All of the following expensing changes are effective for tax years beginning after 2002 and before 2006:

- < The maximum annual expensing amount is \$100,000 (it was \$25,000 before).
- < The maximum annual expensing amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the tax year exceeds a specified dollar level. This dollar level is increased to \$400,000 (from \$200,000).
- < The above increased dollar amounts will be inflation-indexed for tax years beginning after 2003.
- < Off-the-shelf computer software is made eligible for expensing.
- < Taxpayer revocation of expensing elections will no longer require IRS consent.

! Increased Bonus Depreciation

A second major change affecting businesses is an increase and extension of bonus

first-year depreciation. In general, before the 2003 Jobs and Growth Act, a 30% additional first-year depreciation allowance applied to the non-expensed portion of qualified property (which included most new MACRS property) if: (1) its original use commenced with the taxpayer after September 10, 2001; (2) the asset was acquired by the taxpayer after September 10, 2001 and before September 11, 2004; and (3) it was placed in service by the taxpayer before 2005 (before 2006 for certain property with longer production periods). The 2003 Jobs and Growth Act makes the following changes:

- < For 30% bonus first-year depreciation purposes, property can be acquired before 2005.
- < 50% bonus first-year depreciation applies to qualified property if (1) its original use commences with the taxpayer after May 5, 2003; (2) the asset is acquired by the taxpayer after May 5, 2003 and before 2005 (there can't be a written binding contract for acquisition in effect before May 6, 2003); and (3) it is placed in service by the taxpayer before 2005 (before 2006 for certain property with longer production periods).
- < Taxpayers can elect on a class-by-class basis to claim 30% instead of 50% bonus first-year depreciation for qualifying property, or elect not to claim bonus first-year depreciation at all. Two situations in which a taxpayer would likely consider making an election to claim smaller bonus first-year depreciation (or to elect out of it entirely) are where the taxpayer (1) has about-to-expire net operating losses, or (2) anticipates being in a higher tax bracket in future years.

Note that there still is no AMT depreciation adjustment for the entire recovery period of qualified property recovered under the bonus first-year depreciation rules (50% or 30%).

! Delayed Estimated Tax Due Date

Another change for corporations affects only the estimated tax payment rules for 2003. Despite the general rule that estimated tax payment installments must be made no later than April 15, June 15, September 15 and December 15, 25% of the amount of any required installment of corporate estimated tax which is otherwise due in September 2003 will not be due until Oct. 1, 2003. This change affects corporations using (1) the calendar year (third installment of estimated tax would have been due on September 15, 2003); (2) a fiscal year ending March 31, 2004 (second installment would have been due on September 15, 2003); (3) a fiscal year ending May 31, 2004 (first installment would have been due on September 15, 2003); and (4) a fiscal year ending September 30, 2003 (last installment would have been due September 15, 2003). The due dates for all other corporate estimated tax payments aren't changed by the 2003 Jobs and Growth Act provision.

provide accurate information on the subject matter covered. We recommend you consult with your legal and other advisors to determine if the information is applicable in your specific circumstances. If these advisors are not available to you, please feel free to contact Barry N. Finkelstein, CPA at 972/934-1577 or e-mail at info@facpa.com.