

Highlights of the 2003 Tax Act

On May 28, 2003, President Bush signed into law the Jobs and Growth Tax Relief Reconciliation Act of 2003. Containing 10 key tax-related provisions, the scope of the Act is broad and sweeping, going to the fundamentals of tax law. Half of the provisions accelerate, albeit temporarily, tax cuts not set to take effect until 2006. Many of the remaining provisions enhance existing provisions of the Internal Revenue Code.

Primarily focused on individuals, the Act includes reductions in the four top marginal rates and expands the two lower tax brackets. Marriage penalty relief is provided by increasing the standard deduction for married couples and by expanding the 15-percent bracket for joint filers. The child tax credit is increased, with advance payment of the increased benefit starting in July 2003. To ensure that these benefits are not eliminated by the alternative minimum tax (AMT), the AMT exemption was also increased. All of these provisions are effective only for 2003 and 2004, except for the rate reductions, which will be in effect through 2010.

Also included in the Act is a reduction in rates for capital gains and dividends to 15 percent for the four highest tax brackets and 5 percent for the two lower brackets. The 15-percent rate continues through 2008, while the 5-percent rate continues through 2007 and drops to zero for 2008. Two business provisions increase bonus depreciation from 30 to 50 percent through 2004 and increase Code Sec. 179 small business expensing from \$25,000 to \$100,000 for 2003 through 2005. In combination, these changes add up to a significant reduction in taxes, with many potential ramifications for taxpayers making financial and business decisions over the next several years.

Reduction in Top Tax Rates and the Marriage Penalty

The 25-percent, 28-percent, 33-percent and 35-percent tax rates which were scheduled to take effect in 2006 are set to apply to tax years beginning in 2003 through 2010. The 15-percent tax bracket of married taxpayers filing jointly is also immediately increased to twice the size of a single filer's 15-percent bracket, effective for tax years beginning in 2003 and 2004. The standard deduction for joint filers is increased to twice the amount of a single filer's standard deduction. It is likewise immediately effective for the 2003 and 2004 tax years.

For 2003 and 2004, the 10-percent bracket for married taxpayers filing jointly will increase by \$2,000 (from \$12,000 to \$14,000), and the 10-percent bracket of single filers and married taxpayers filing separately will increase by \$1,000 (from \$6,000 to \$7,000). The 10-percent bracket for heads of household remains at \$10,000.

As a result of these changes the 2003 tax rate schedules are as follows:

Caution: The following 2003 tax rate schedules are unofficial.

**Post-2003 Act—Single Individuals
2003**

Taxable Income		Pay	+	% on Excess	of the amount over—
Over	But Not Over				
\$ 0	— \$ 7,000	\$ 0		10 %	\$ 0
7,000	— 28,400	700.00		15	7,000
28,400	— 68,800	3,910.00		25	28,400
68,800	— 143,500	14,010.00		28	68,800
143,500	— 311,950	34,926.00		33	143,500
311,950	—	90,514.50		35	311,950

**Post-2003 Act—Married Filing Jointly and Surviving Spouses
2003**

Taxable Income		Pay	+	% on Excess	of the amount over—
Over	But Not Over				
\$ 0	— \$ 14,000	\$ 0		10 %	\$ 0
14,000	— 56,800	1,400.00		15	14,000
56,800	— 114,650	7,820.00		25	56,800
114,650	— 174,700	22,282.50		28	114,650
174,700	— 311,950	39,096.50		33	174,700
311,950	—	84,389.00		35	311,950

**Post-2003 Act—Married Filing Separately
2003**

Taxable Income		Pay	+	% on Excess	of the amount over—
Over	But Not Over				
\$ 0	— \$ 7,000	\$ 0		10 %	\$ 0
7,000	— 28,400	700.00		15	7,000
28,400	— 57,325	3,910.00		25	28,400
57,325	— 87,350	11,141.25		28	57,325
87,350	— 155,975	19,548.25		33	87,350
155,975	—	42,194.50		35	155,975

**Post-2003 Act—Heads of Households
2003**

Taxable Income		Pay	+	% on Excess	of the amount over—
Over	But Not Over				
\$ 0	— \$ 10,000	\$ 0		10 %	\$ 0
10,000	— 38,050	1,000.00		15	10,000
38,050	— 98,250	5,207.50		25	38,050
98,250	— 159,100	20,257.50		28	98,250
159,100	— 311,950	37,295.50		33	159,100
311,950	—	87,736.00		35	311,950

**Post-2003 Act—Estates and Nongrantor Trusts
2003**

Taxable Income				% on	of the
Over	But Not	Pay	+	Excess	amount
\$ 0	Over	\$ 0		15 %	over—
1,900	— \$ 1,900	\$ 0		15 %	\$ 0
4,500	— 4,500	285.00		25	1,900
6,850	— 6,850	935.00		28	4,500
9,350	— 9,350	1,593.00		33	6,850
	—	2,418.00		35	9,350

Filing Requirements

The increase in the standard deduction for a married couple increases the gross income threshold for filing a tax return for certain taxpayers. The new 2003 filing requirements are as follows:

Filing Status

Single

Under 65	\$7,800
65 or older	8,950
Dependent with unearned income	750
Dependent with no unearned income	4,750

Married Filing Joint Return

Both spouses under 65.....	\$15,600
One spouse 65 or older	16,550
Both spouses 65 or older.....	17,500

Married Filing Separate Return

All	\$3,050
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Head of Household

Under 65	\$10,050
65 or older	11,200

Surviving Spouse

Under 65	\$12,550
65 or older	13,500

Acceleration and Advance Payment of Child Tax Credit Increase

The child tax credit (CTC) increases from \$600 to \$1,000 per qualifying child, effective for tax years 2003 and 2004. Advance payment of CTC increase. In 2003, the increase in the CTC will be paid or credited in advance using the taxpayer's 2002 tax return as the basis of information. There are two prerequisites for receiving the CTC refund amount:

- (1) the taxpayer was allowed a CTC in 2002, as reflected on the 2002 tax return; and
- (2) the taxpayer had a qualifying child (or children) in 2002 who is under age 17 as of December 31, 2003.

Reduction in Capital Gains Rates for Individuals

The new legislation lowers the maximum tax rates that are generally applied to long-term capital gains. The following rate reductions have been made:

A 15-percent maximum tax rate replaces the 20-percent rate that existed under prior law.

A 5-percent rate replaces the 10-percent rate for individuals in a 10-percent or 15-percent tax bracket.

Because the reduction in long-term capital gains rates was not retroactive to January 1, 2003, most individuals will find that their capital gains tax for 2003 must be computed under a transitional rule. This rule applies in situations involving a tax year that includes May 6, 2003.

Dividend Income of Individuals Taxed at Capital Gains Rates

The top federal tax rate for dividends received by an individual is reduced by the new law to 15 percent (5 percent for those whose incomes fall in the 10- or 15-percent rate brackets). These are the same rates applicable to capital gains. The reduced rates apply to eligible dividends received from January 1, 2003, through December 31, 2008.

Interest earned on savings accounts, certificates of deposits, and government bonds is still subject to federal income tax at ordinary tax rates. The new low tax rates apply only to stock dividends. Investments in tax-deferred retirement vehicles such as regular IRAs, 401(k)s and deferred annuities receive no benefit from the rate reduction. Distributions from these accounts will be taxed at ordinary income tax rates even if the funds represent dividends paid on stocks held in the account.

Increase and Extension of Bonus Depreciation

The new law increases the additional first-year depreciation allowance percentage from 30 percent to 50 percent. To qualify for the higher percentage, the property must be acquired after May 5, 2003, and placed in service before January 1, 2005 (January 1, 2006, for property with a longer production period). The 50-percent rate does not apply if a binding written contract for acquisition of the property was in effect before May 6, 2003. Property of the type which meets the requirements for the 30-percent bonus depreciation deduction will qualify for the 50-percent rate if the preceding acquisition and placed-in-service dates are met. Taxpayers may elect to continue to use the 30-percent rate.

Increased Expensing for Small Business

The maximum dollar amount that may be deducted under Code Sec. 179 is increased from \$25,000 to \$100,000 for qualifying property placed in service in tax years beginning after 2002 and before 2006 and will be adjusted for inflation.

The \$200,000 amount used to compute the phase-out of the deduction is increased to \$400,000 for qualifying property placed in service in tax years beginning after 2002 and before 2006.

Thus, for tax years beginning in 2003, 2004 and 2005, the \$100,000 maximum Code Sec. 179 deduction is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the year exceeds \$400,000. The \$400,000 phase-out threshold will be adjusted for inflation.

Off-the-shelf computer software to which Code Sec. 167 applies and that is placed in service in tax years beginning after 2002 and before 2006 is now included as qualifying property that may be expensed under Code Sec. 179. Computer software is defined as software that is readily available for purchase by the general public, is subject to a nonexclusive license, and has not been substantially modified. In addition, computer software does not include any database or similar item unless it is in the public domain and is incidental to the operation of otherwise qualifying computer software.

Alternative Minimum Tax

The AMT exemption amount is increased to:

\$58,000 for joint return filers and surviving spouses in tax years beginning in 2003 and 2004;

\$40,250 for a single individual who is not a surviving spouse in tax years beginning in 2003 and 2004; and

\$29,000 for a married taxpayer who files a separate return in tax years beginning in 2003 and 2004.

Under the new legislation, and effective for dispositions of small business stock on or after May 6, 2003, only 7 percent of the 50-percent exclusion is treated as a tax preference item when computing AMTI. As a result of this change, 3.5 percent ($50\% \times 7\%$) of the investor's total realized gain from the sale or exchange of small business stock will be used in the computation of AMTI.

Accumulated Earnings Tax and Personal Holding Company Tax

Under prior law, the accumulated earnings tax was equal to the product of the highest rate of tax applicable to single filers and a corporation's accumulated taxable income. The personal holding company tax was computed by multiplying undistributed personal holding company income by the highest rate of tax on single filers. The new law, however, reduces the tax rate for the accumulated earnings tax and personal holding company tax to 15 percent effective for tax years beginning after December 31, 2002, and beginning before January 1, 2009.

2003 Corporate Estimated Payments

The new law provides that with respect to the corporate estimated tax payment that would have been due in September 2003, 25 percent of the amount of the required installment is not due until October 1, 2003.