



BUSINESS COUNSELING UPDATE

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JOBS AND GROWTH TAX RELIEF RECONCILIATION ACT OF 2003

On May 23rd, Congress passed the Jobs and Growth Tax Relief Reconciliation Act of 2003, representing a major tax cut package that is being billed as the third largest in U.S. history. President Bush signed the Act into law on May 28th. The effective dates of the tax changes are varied. In this special issue, we highlight the changes contained within the Act.

Tax Rate Reductions

The new law contains across-the-board reductions in the tax rates for ordinary taxable income, capital gains and dividend income.

Ordinary Income

The Act accelerates the rate cuts that were to be phased-in under the 2001 tax bill, rates that weren't scheduled to take effect until 2006. The highest rate, now at 38.6%, falls to 35%. In general, all of the rates above 15% fall by about 2%. The Act also raises the taxable income levels for the 10% bracket, giving a benefit to all taxpayers regardless of their marginal tax rate.

The new rates are effective retroactively to January 1, 2003. The new rates remain subject, however, to the sunset provisions of the 2001 tax bill, meaning they revert to the 15, 28, 31, 36 and 39.6% levels after 2010. The old thresholds for the 10% bracket return in 2006, but are gradually increased by 2008.

Current Individual Rates	New Individual Rates
10%	10%
15%	15%
27%	25%
30%	28%
35%	33%
38.6%	35%

» Given the retroactive effective date, taxpayers may be able to reduce their withholding and/or estimated tax payments to reflect the rate cuts.

» With individual rates now lower than corporate rates, conducting your business as a passthrough tax entity (i.e. "S" corporation or limited liability company) offers tax benefits.

Corporate Taxable Income	Corporate Tax Rate
\$75,000 - \$100,000	34%
\$100,000 - \$335,000	39%
\$335,000 - \$1,000,000	35%

Capital Gains

Under the Act, the maximum net capital gains tax rate is immediately reduced from 20% to 15%. The current 10% capital gains rate, applicable to lower-income taxpayers, is reduced to 5%. The new rates are effective for transactions occurring on or after May 6, 2003 through December 31, 2007. For 2008, the 5% rate drops to zero, but only for that year. The 15% rate remains in place for 2008. The new rates apply for both regular tax and alternative minimum tax (AMT) purposes.

The Act repeals the old 18% capital gain rate (8% for lower income taxpayers) enacted in 2001 for certain five-year property. The repeal is effective May 6, 2003. The repeal could be a problem for taxpayers who made deemed sale elections for 2001. They may not receive any benefit for having paid tax on pre-2001 appreciation.

» The spread between the ordinary income rates and the capital gains rates has now increased to 20%. The increased spread makes it even more important for taxpayers in higher ordinary income brackets to realize long-term capital gains rather than short-term capital gains or ordinary income.

» Taxpayers with appreciated assets may want to consider transferring them to children over the age of 13. If the child qualifies for the 10% ordinary tax bracket, a sale of the appreciated asset in 2008 may escape taxation all together. This opportunity would not be available for children 13 or younger, who are subject to the "kiddie tax" at their parents' rate.

Dividends

Under the new Act, dividend income received by an individual from a domestic or qualified foreign corporation generally will be taxed at a maximum rate of 15%. Lower income individuals will pay tax on dividend income at a 5% rate.

Although the dividend tax reductions are temporary, they are also retroactive. The new 15% rate is effective for dividends received in tax years beginning after 2002. The dividend rate reduction ends on December 31, 2008. For 2008, however, the

5% rate for lower income taxpayers drops to zero, but only for that year. The old tax rates return in 2009. Certain dividend income is specifically exempted from the new rates, so a careful review of the requirements is necessary.

» Under current law, a taxpayer in the 38.6% marginal income tax bracket who receives \$100,000 of dividend income would pay \$38,600 in taxes. Under the new law, the same dividend income would be taxed at 15%, resulting in a \$15,000 tax liability and a net tax reduction of \$23,600.

» The 15% tax on dividend income will not be netted with the 15% capital gains rate. Consequently, current capital losses and capital loss carryovers will not be available to offset dividend income.

» Dividends paid to an untaxed account, such as a 401(k) plan, are not eligible for the reduced tax rate.

» The new rates applicable to dividend income do not apply to distributions from "S" corporations. "S" shareholders are taxed on their pro rata share of the "S" corporation's net income and not on dividend distributions from an "S" corporation per se. "S" corporation shareholders will continue to pay income tax on their pro rata share of "S" corporation earnings at ordinary income tax rates.

» The real estate industry may view the new Act as a mixed bag. Investors who own REIT stocks won't be eligible for the reduced tax rates applicable to dividend income since REIT distributions do not qualify. However, the capital gains rate cuts may be good for commercial real estate owners holding appreciated properties.

Business Tax Relief

Bonus Depreciation

Under the new Act, bonus depreciation is increased to 50% for property acquired after May 5, 2003 and before January 1, 2005. In order to qualify for the effective date, there must have been no binding purchase contract in place before May 6, 2003.

Bonus depreciation continues to be in addition to regular depreciation,

however it is not in addition to the 30% bonus depreciation implemented under the 2002 tax bill. Taxpayers may combine the 50% bonus depreciation with a Section 179 expensing of the remaining tax basis of new property. Taxpayers should note, however, that bonus depreciation applies only to new property, while Section 179 expensing may be taken on new or used property. The old 30% bonus depreciation provisions continue to apply to property acquired between September 11, 2001 and May 6, 2003.

» The new law raises the bonus depreciation ceiling on luxury autos from \$4,600 to \$7,650.

» While the immediate expensing provisions of Section 179 are subject to a dollar limitation, bonus depreciation is not subject to such a limit.

Section 179 Small Business Expensing

Under prior law, business taxpayers could immediately deduct under Section 179 up to \$25,000 of qualified property placed in service in lieu of claiming a depreciation deduction. The new Act increases the level of that current deduction to \$100,000. The Act also raises the phase-out threshold from \$200,000 to \$400,000. The new limits apply to property placed in service during 2003, 2004 and 2005. The Act also adds off-the-shelf computer software to the definition of qualifying property. Under prior law, off-the-shelf computer software did not qualify for immediate expensing.

» The new Section 179 limits also make luxury SUVs more attractive than ever for small business owners. SUVs are not subject to the luxury car limits governing either Section 179 or the new 50% bonus depreciation.

» Tax savings can be maximized by carefully selecting assets for Section 179 expensing. The election can be applied against the entire cost or a portion of the cost of one or more items of qualifying property. Accordingly, it makes sense to



allocate the allowance to property with the longest recovery period.

» No changes have been made to the rules governing deductibility of ordinary and necessary business expenses or the capitalization rules. As a result, successfully establishing that an expenditure qualifies as a deductible business expense rather than acquisition of a capital asset yields a current deduction without resorting to Section 179 expensing which would use up part or all of the new \$100,000 limit.

Individual Tax Relief

Alternative Minimum Tax (AMT)

The new Act did not reform the AMT. It did, however, raise the AMT exemption amounts to \$40,250 for single taxpayers and \$58,000 for married couples. The exemption increases are effective only for tax years beginning in 2003 and 2004.

Marriage Penalty

The new Act immediately doubles the standard deduction for married couples to two times the amount of the standard deduction for single taxpayers. The increase is temporary, however, effective for 2003 and 2004. In 2005, the standard deduction for married couples will fall to 180% of the standard deduction for single taxpayers, and then increase to two times the amount by 2009.

Child Tax Credit

Under prior law, the child tax credit was to gradually increase to \$1,000 by 2010. The new Act immediately increases the credit from \$600 to \$1,000, effective for 2003 and 2004. In 2005, the credit is reduced to \$700 but increases to \$1,000 by 2010 under the prior law.

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