

July 2, 2003

Dear Clients and Friends,

The ***Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA)*** was passed by both houses of Congress on May 23, 2003, after months of fierce debate. President Bush signed it into law on May 28, 2003. The law provides approximately \$330 billion of tax cuts over the next ten years, plus \$20 billion of aid to states.

The law is unusual in several respects. First, it affects a very large number of individual and business taxpayers. Second, in order to stimulate the economy, most of the changes are effective immediately, with many retroactive to January 1, 2003. Finally, many of the changes apply only for two or three years. They then disappear unless they're extended by Congress in some future piece of legislation. This was done to keep the overall cost within limits, but it makes careful tax planning more important than ever. You'll have to keep an eye on both the rules and the calendar.

The most sweeping change created by the *2003 Tax Act* is in the taxation of investment income. The law reduces tax rates on income from most dividends and long-term capital gains through 2008. At a minimum, this should prompt you to review your investment strategy. Other changes affecting individuals include a reduction in tax rates and an expansion of certain tax brackets, a temporary increase in the child tax credit, and some relief from the marriage penalty and the alternative minimum tax.

Two impacts of the new law will be very visible in the coming months. Employees should see higher paychecks in July as withholding is reduced to reflect lower tax rates. In late summer many families with children should expect to receive rebate checks for the increase in the 2003 child tax credit.

The legislation contains two provisions designed to boost the economy by encouraging business spending. Small businesses can now write off more of the cost of equipment in the year of purchase rather than deducting the expense over several years. And all businesses can take a first-year bonus depreciation deduction of 50% of the cost of *new* equipment purchased after May 5, 2003.

The following sections provide general information on the major changes in the new law. Please take a few minutes to review them. Then if you have questions about how the law will affect you, or if you want to update your tax planning in response to the new law, please contact our office.

TAX RATES

- Retroactive to January 1, 2003, rates in the top four brackets decrease by 2% or more. This is an acceleration of changes originally scheduled by the *Tax Act of 2001* to take place in 2004 and 2006.

<u>Old Rates</u>	<u>New Rates</u>
38.6%	35%
35%	33%
30%	28%
27%	25%
15%	No change
10%	No change

- Rates in the 10% and 15% brackets do not change. However, the upper end of the 10% bracket increases from \$6,000 to \$7,000 for single filers and from \$12,000 to \$14,000 for joint filers. This change applies only for 2003 and 2004. The lower thresholds go back into effect in 2005.
- The upper end of the 15% bracket increases for married taxpayers filing joint returns as part of marriage penalty relief (see below).
- Employees can expect to see larger paychecks in July based on the new IRS withholding tables that reflect the tax rate and tax bracket changes. Self-employed taxpayers may wish to adjust their estimated tax payments to reflect the new lower rates for 2003.
- To provide some relief from the alternative minimum tax, which has begun affecting an increasing number of middle-income taxpayers, the exemption amount for single taxpayers increases from \$35,750 to \$40,250. The exemption for married couples increases from \$49,000 to \$58,000. This increase is effective only for 2003 and 2004.

MARRIAGE PENALTY

- The new law provides some relief from the marriage penalty. The “marriage penalty” refers to the fact that some married couples pay higher taxes than the combined taxes they paid as singles on the same income.
- To ease the problem, the upper end of the 15% tax bracket increases from \$47,450 to \$56,800 for married joint filers. This is exactly twice the amount of the 15% bracket for single filers, thus removing part of the marriage penalty.
- In addition, the standard deduction for married couples increases from \$7,950 to \$9,500, which is twice the \$4,750 standard deduction for single filers.
- This relief applies only in 2003 and 2004. In 2005, the less extensive marriage penalty relief provided in the *Tax Relief Act of 2001* takes effect. The 2001 law gradually increases the 15% tax bracket and the standard deduction for married couples until 2009 when they are once again twice those of singles.

CHILD CREDIT

- The new law immediately increases the child tax credit from \$600 to \$1,000 per child under age 17. Under the old law, the credit was slowly ramping up to reach the \$1,000 level in 2010.

- This higher credit applies only for two years. In 2005 it will drop back to \$700, increasing to \$800 in 2009 and to \$1,000 in 2010. Again, Congress might act to make the higher level permanent before then.
- Congress has instructed the IRS to pay the 2003 increase in advance by issuing checks of up to \$400 per child. Eligible taxpayers should expect to receive these rebate checks towards the end of summer.
- Not all taxpayers will receive checks, however. The IRS will estimate the amounts payable based on data from last year's returns. If you have a child born this year, for example, you should not expect a check for that child. Instead you will claim the credit on your 2003 tax return.
- Higher-income taxpayers may not qualify for the full credit. It starts to phase out when adjusted gross income reaches \$110,000 for joint filers (\$75,000 for singles or heads of household).

DIVIDENDS AND CAPITAL GAINS

- One of the biggest changes in the new law reduces the tax investors will pay on most dividends and long-term capital gains. The reductions apply to dividends received any time in 2003 and to long-term capital gains realized on or after May 6, 2003.
- Taxpayers in the top four tax brackets will pay 15% tax on most dividend income received through 2008. Taxpayers in the 10% and 15% ordinary income brackets will pay 5% through 2007 and 0% in 2008. These new rates expire in 2009 unless extended by Congress.
- The new reduced rates apply to most corporate dividends received by individual shareholders. Previously dividends were taxed as ordinary income, with a top rate as high as 38.6%.
- The same new rates of 15%, 5%, and 0% also apply to most long-term capital gains. Taxpayers in the top four brackets will pay 15%, down from the current 20%. For those in the lower two brackets, the rate drops from the current 10% to 5% through 2007 and to 0% in 2008. In 2009, the old capital gain rates return unless Congress changes the rates again.
- The prior law's 18% and 8% rates for five-year capital gains are effectively repealed until 2009 when they once again go into effect. Taxpayers who made "deemed sale" elections on their 2001 tax returns in order to benefit from these five-year rates will need to stay aware of whatever information the IRS releases on this issue.
- Note that these rate changes do not affect dividends or capital gains received in tax-free funds such as traditional IRAs or 401(k) plans. Withdrawals from these plans are taxed at ordinary income rates regardless of the source of the earnings.

BUSINESS INVESTMENT

- The new law contains two provisions intended to boost the economy by encouraging business spending.
- In 2003 through 2005, small businesses can take an immediate write-off for up to \$100,000 of equipment purchases each year. The previous limit on this expensing option

was \$25,000. This benefit begins to phase out when total purchases in any year exceed \$400,000; the prior phase-out threshold had been \$200,000.

- The new law also increases and extends the bonus depreciation that was introduced in 2002 tax legislation. Businesses can now claim a first-year bonus depreciation of 50% of the cost of most *new* equipment purchased after May 5, 2003, and before January 1, 2005. The previous law allowed 30% bonus depreciation, which can still be taken for new business equipment purchased between September 11, 2001, and May 6, 2003.
- Note that bonus depreciation applies only to new property while expensing may be taken on new or used property. Also, the two benefits can be combined; the expensing option can be taken for a purchase, and the 50% bonus depreciation can be used on the remaining basis if the property qualifies.

NEXT STEPS

This summary gives you the key elements of the recent tax changes. The new law is far-reaching and will affect the majority of taxpayers in some way. It is also complex, with various effective dates, expiration dates, limitations, and exceptions.

Though President Bush had proposed significant changes to retirement and college savings plans, this new legislation does not include any provisions changing these plans.

We want you to get the best tax treatment possible under this new legislation, and we are ready to assist you in making wise tax and financial choices. Please call for details on any provision in the tax law that concerns you or to make an appointment for a more specific review of your tax situation.

Sincerely,

Sharff, Wittmer, Kurtz & Jackson