BATTERSHELL & CO.
A PROFESSIONAL SERVICE CORPORATION

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Overview of the "Jobs and Growth Tax Relief Reconciliation Act of 2003"

In response to heavy pressure from the Bush administration, Congress passed tax cut legislation just before its Memorial Day 2003 recess.

The new law accelerates previously scheduled individual income tax rate cuts and grants short-term tax incentives for certain types of business investment. In general, the main beneficiaries are individual investors, small businesses planning to invest in new equipment or off-the-shelf computer software, and middle income families with minor children. Almost all individuals who pay federal income tax will experience some tax reduction, and wage-earners should see some of this reflected in lower withholding taxes during the second half of 2003.

This letter gives you a brief overview of the new law, officially named the "Jobs and Growth Tax Relief Reconciliation Act of 2003" to reflect its intended purpose of stimulating the economy. Please feel free to contact us for additional information or to set up an appointment to discuss strategies for maximizing your benefits under the new law, including any reductions in your estimated tax payment schedule for 2003.

15% Top Rate on Dividends and Capital Gains

For many individuals, the new law makes a deep cut in the tax on dividends received in 2003 through 2008. Instead of being taxed at an individual's top bracket—up to 35%—qualified dividends will be taxed at a maximum of 15% (less for taxpayers in the two lowest brackets). Thus, for example, $6,000 of qualified dividends would incur a tax of $900 instead of $2,100.

In general, dividends eligible for this preferred treatment must come from domestic corporations or "qualified foreign corporations," including corporations organized in U.S. possessions, foreign corporations whose stock is traded on an established U.S. securities market, and certain other foreign corporations to be designated based on criteria set out in the new law.

Complementing the dividends tax cut is a cut in the top rate on most net capital gains to 15% (less for individuals in the two lowest brackets) through 2008. Unlike the dividends cut, however, the effective date of the capital gains cut is not retroactive to the beginning of tax year 2003. Instead, the new rate generally applies to sales on or after May 6, 2003. The prior-law top rate—generally, 20%—applies to most net capital gains realized before that date.

Note that the new law reduces the top rate on dividends and net capital gains to 5% for taxpayers in the two lowest income tax brackets (i.e., 10% and 15%) through 2007 and to 0% in 2008. Taxpayers contemplating gifts to family members in these income tax brackets need to take the new top rates into account in selecting the gift property. Our office will be happy to help you "crunch the numbers" and otherwise assess the advantages and disadvantages of various options.

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Individual Income Tax Cuts

The new law retroactively reduces the top four rate brackets to the levels previously scheduled to take effect in 2006. The following table shows these changes:

New rates 2003-2010	Old rates 2003	Reduction (percentage points)
10%	10%	-0.00-
15%	15%	-0.00-
25%	27%	-2.00-
28%	30%	-2.00-
33%	35%	-2.00-
35%	38.6%	-3.60-

Also, the new law retroactively, albeit temporarily, accelerates the expansion of the 10% bracket by increasing the level of income taxed at that rate in taxable years 2003 and 2004. For 2003, joint filers and surviving spouses will pay 10% on the first $14,000 (versus $12,000) of taxable income and single filers will pay at that rate on the first $7,000 (versus $6,000). For 2004, the $14,000/$7,000 amounts are to be adjusted for inflation. But the 10% bracket will revert to the previous levels of $12,000/$6,000 from 2005 through 2007, return to the $14,000/$7,000 levels for 2008, and be adjusted for inflation after 2008.

"Marriage Penalty" Relief

Although the 2001 tax cut legislation included "marriage penalty" relief, it deferred implementation until taxable year 2005, at which point the relief was to be phased in over several years. The new law temporarily accelerates this relief in taxable years 2003 and 2004 by:

- Expanding the 15% bracket for joint filers to 200% of the amount applicable to single filers. Beginning in 2005, the previous schedule will apply (i.e., 180%, 187%, 193% in 2005-2007, 200% in 2008 and thereafter).
- Increasing the standard deduction for joint filers to 200% of the amount applicable to single filers. Beginning in 2005, the previous schedule will apply (i.e., 174%, 184%, 187%, 190% in 2005-2008, 200% in 2009 and thereafter).

Child Tax Credit Increase

The new law temporarily increases the maximum child tax credit to $1,000 (from $600) per child for taxable years 2003 and 2004. Beginning in 2005, the previous schedule will apply (i.e., $700 in 2005-2008, $800 in 2009, and $1,000 in 2010 and thereafter).

Any taxpayer who was allowed a child tax credit for 2002 may receive an advance payment of the increased credit amount for 2003—up to $400 per child—before October 1, 2003, based on information from the 2002 return.

Note that the new law did not change the phase-out rule whereby the credit amount is reduced at the rate of $50 for each $1,000 (or fraction) by which a taxpayer's "modified adjusted gross income" exceeds certain threshold amounts. For example, the phase-out range begins at $110,000 for joint filers.

Alternative Minimum Tax Relief for Individuals

The new law temporarily increases the alternative minimum tax exemption amount for 2003 and 2004 by $9,000 for joint filers and surviving spouses and by $4,500 for single filers and married filing separately. Thus, the exemption amounts in those years will be $58,000 for joint filers and surviving spouses, $40,250 for single filers, and $29,000 for married filing separately.

These increased exemption amounts are estimated to substantially reduce the number of individuals subject to the alternative minimum tax in 2003 and 2004. Beginning in 2005, however, the exemption amounts are scheduled to drop significantly: to $45,000 for joint filers and surviving spouses, $33,750 for single filers, and $22,500 for married filing separately. Hence, absent future Congressional action, the alternative minimum tax could become a major tax "trap" for many individuals.

Future Tax Legislation

Congress has plenty of unfinished tax legislative business remaining.

For example, military tax relief legislation has received widespread support, as has a measure to permit non-itemizers to deduct charitable contributions. Legislation that would make major changes in the U.S. international tax rules has been pending for some time. Several pending initiatives are intended to combat tax shelters.

Proposals that would significantly affect the tax treatment of retirement plans and employee benefits may receive serious consideration later this year. Moreover, many temporary provisions contained in previous legislation will expire in 2003 unless Congress acts to extend them. Examples include the Work Opportunity Credit and the Welfare-to-Work Credit. Finally, many lawmakers are urging further, permanent tax cuts and additional business investment incentives.

Predicting which, if any, of these measures will be passed is difficult at best. Our firm will continue to monitor developments and advise you of significant tax legislation as conditions warrant.

Please feel free to contact me with any questions.

Rick Battershell