

New Federal Tax Cuts Become Reality

The Jobs and Growth Tax Relief Reconciliation Act of 2003 (the "2003 Tax Act"), which was signed into law on May 28, 2003, will reduce the federal income tax burdens of most Americans. By planning your financial affairs with an understanding of the changes, you have the potential to reap tremendous tax savings. Accordingly, this issue of the TS Newsletter provides an overview of the 2003 Tax Act, and we encourage you to contact us if you have any questions.

Tax Rates Fall Again

Rate reductions that began in 2001 have been accelerated under the 2003 Tax Act, and additional taxpayer friendly provisions have been implemented, as follows:

- 1) **Marginal Rates** are applied to a broad spectrum of income, including wages, taxable interest, self-employment income, short-term capital gains, and certain retirement plan and social security distributions. Based on the newly enacted rate changes, which became effective January 1, 2003, the top marginal rate has been reduced from 38.6% to 35% and the next three lower rates have each been reduced by 2%. Additionally, the bracket for the lowest rate, which is currently 10%, has been expanded by up to \$2,000, depending on filing status. As a result, most employees will take home more of their earnings each pay period, and many taxpayers are likely to receive refunds on their 2003 federal tax returns.
- 2) **Long-Term Capital Gains Rates** have long been preferable to marginal rates. These rates generally apply to net profits from selling stocks & bonds held longer than 12 consecutive months. Starting in May 2003, the top rate applied to long-term capital gains from sales of stocks and bonds will drop from 20% to 15%.
- 3) Until passage of the 2003 Tax Act, **Dividends** received by an individual were taxed at marginal rates. Now, dividends received by individuals are taxed at the same rates as net long-term capital gains. Individual investors with significant after-tax holdings of dividend paying stocks and owners of closely held C corporations are likely to reap the greatest benefits from these changes.
- 4) The purpose of the **Alternative Minimum Tax ("AMT")** has traditionally been to ensure that certain individuals pay at least a minimum amount of tax. Currently, the AMT affects only a small proportion of taxpayers, but the percentage has been steadily increasing. In light of these facts, the 2003 Tax Act increased the amount of income that is exempt from the AMT, and this change should reduce the growth of AMT liability.

You May be Receiving a Check

The 2003 Tax Act increased the **Child Tax Credit** from \$600 to \$1,000, and starting later this month, the federal government will be mailing advance payments of the difference to certain taxpayers.

Previously, the credit was determined by multiplying the number of qualifying children¹ by \$600 and then reducing the taxpayer's total income tax after certain other credits were first applied. Only taxpayers earning less than \$110,000 if married filing jointly, \$75,000 if single, or \$55,000 if married filing separately were eligible to claim the full credit, and the credit could not be used to obtain a "refund" if the taxpayer had \$0 tax liability.

For 2003, the credit is calculated by multiplying the number of qualifying children by \$1,000. The advance payments will reduce the total child tax credit which otherwise may be claimed on the 2003 return, so it's important to let your tax preparer know if you receive a check and for how much. Also, if you receive an advance payment check, but you are not eligible to claim the child tax credit on your 2003 return, you don't need to pay it back! Finally, certain taxpayers with \$0 income tax liability may now utilize the credit to obtain a refund.

Marriage Penalty Reduced

The marriage penalty exists when a married couple in which both spouses work pays more income taxes than if they remained single. The 2003 Tax Act reduces this penalty based on the following two changes:

- 1) The standard deduction for married couples filing joint returns has been increased to twice that of single filers (this change does not provide relief to couples who itemize deductions).
- 2) The 15% bracket for married couples filing joint returns has been expanded to double the amount for single filers.

Increased Deductions for Businesses

Until recently, businesses wrote-off most purchases of equipment, furniture, vehicles, and other fixed assets over a series of years using depreciation. Based on legislation passed in 2002, many businesses were able to write-off purchases of certain fixed assets in the year of acquisition rather than spreading the deductions over several years, and the 2003 Tax Act greatly expands this benefit.

Specifically, up to \$100,000 of certain fixed assets acquired in 2003 can be fully deducted in 2003, and the first year depreciation rate for certain fixed assets that are not fully deducted has been increased dramatically. For businesses planning major purchases, now may be a great time to implement such plans for income tax purposes.

The *TS Newsletter* is distributed exclusively to TaxpayerServices clients and associates. The content of this newsletter is for informational purposes only and should not be relied upon as tax or legal advice. Copyright © 2003 TaxpayerServices, LLC. All Rights Reserved.

¹ A "qualifying child" is one who 1) is claimed as a dependent on the taxpayer's income tax return, 2) is under age 17 as of December 31 of the tax year, 3) is the taxpayer's child, foster child, grandchild, or sibling, and 4) is a U.S. citizen or resident.