

## Winter 2004

### The Latest Federal Tax Package: What's in It for Me?

After much debate, Congress passed a new round of tax cuts in the Jobs and Growth Tax Relief Reconciliation Act of 2003. The act contains no tax increases and provides several benefits to investors and small business owners.

All of the tax cuts, however, are subject to "sunset" provisions, which will return the various rates to previous levels at some time in the future unless Congress acts to extend the breaks.

#### Accelerated Rate Reductions

Among the most prominent provisions of the latest tax package is the acceleration of individual income tax rate cuts that were included in the 2001 tax legislation. The cuts, which drop the maximum tax rate on ordinary income to 35%, were initially scheduled to take effect in 2004 and 2006 but will now be effective for 2003. Tax rates will return to the pre-2001 rates after 2010 under a sunset provision.

#### Benefits for Investors

Despite President Bush's highly publicized proposal to eliminate the dividend tax completely, the package only reduces the tax, albeit significantly. From 2003 to 2008, qualified dividends from domestic companies and qualified foreign companies will be subject to a tax of no more than 15%. Even lower rates apply for taxpayers in the lowest tax brackets.

To qualify for the slashed dividend tax rates, the stock must have been held for more than 60 days during the 120-day period that began 60 days before the last date on which shareholders are entitled to receive the upcoming dividend. Otherwise, dividends will be taxed as ordinary income, at rates as much as 35%.

Also, dividends received in tax-deferred retirement accounts are still taxed at the rate for ordinary income if withdrawn as cash distributions.

Long-term capital gains on sales transacted after May 5, 2003, will be taxed at a ceiling of 15%, with lower rates for taxpayers in the 10% and 15% brackets. Long-term real estate gains attributable to depreciation deductions, however, can be taxed up to 25%.

Long-term gains from sales of collectibles and certain small business stock can be taxed at as much as 28%. Again, the reduced rates don't apply to tax-deferred retirement accounts. The previous rates are scheduled to return to effect in 2009.

#### Benefits for Small Business

Small business owners may find the greatest benefit of the new tax package to be the dramatic jump in the amount of the Section 179 deduction. Under the section, business owners generally can deduct the entire cost of new and used personal property assets in the year these assets are placed into service.

Previously, the deduction was limited to \$25,000 per year; now, business owners can deduct up to \$100,000 for equipment additions in the first year in 2003, 2004 and 2005, subject to a taxable-income based limit and a limit triggered by adding

more than \$400,000 of qualifying assets in a single tax year.

The increase in the so-called "expensing deduction" has drawn the attention of some businesses to an existing provision addressing vehicles used for business.

Generally, an automobile that has been purchased for business purposes must be depreciated annually. If the vehicle's weight exceeds 6,000 pounds, however, it's not treated as a car and is subject to expensing in the year purchased, within the \$100,000 limit.

The 2003 package also increases the bonus depreciation rate to 50% of the property's cost basis for property acquired after May 5, 2003, and before Jan. 1, 2005.

Under the Job Creation and Worker Assistance Act of 2002, businesses could take first-year depreciation deductions equal to 30% of the adjusted basis of qualifying property acquired between Sept. 11, 2001, and Sept. 10, 2004. Qualified property includes assets with a depreciable life of 20 years or less and qualified leasehold improvements.

#### **A Caveat About AMT**

Although the act increases the alternative minimum tax exemption for 2003 and 2004, taxpayers should be aware that more and more individuals will be subject to the higher AMT taxes.

These taxes must be paid if the AMT is greater than the taxpayer's ordinary income tax. The reduced tax rates on ordinary income mean that AMT, which doesn't recognize deductions like property and state income tax, exemptions, and miscellaneous itemized deductions, will be greater than ordinary income tax more often.

Some tax planning may be possible, however, such as delaying deductible payments of items like state income tax. Taxpayers need to review their options with their advisors now, rather than after the end of the tax year.



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