Job and Growth Tax Relief Reconciliation Act of 2003

Earlier today, Congress passed the Job and Growth Tax Relief Reconciliation Act of 2003 (the "Bill"). The President has indicated that he will sign the Bill. Once enacted, the Bill will:

- temporarily accelerate the rate reductions enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Act");

- temporarily lower the top long-term capital gain rate to 15% and lower the rate on most dividends to 15%; and

- increase and extend the "bonus depreciation" for new depreciable business property enacted by the Job Creation and Worker Assistance Act of 2002 (the "2002 Act") and increase the amount of depreciable business property that small businesses may currently deduct.

These rate reductions are the most significant reductions in income tax rates (especially on investment income) since 1986, and will create many planning opportunities. The following is a brief summary of the tax provisions of the Bill most likely to be relevant to our clients.

Individual Income Tax Rate Reductions

- The current 38.6%, 35%, 30% and 27% income tax rates will be reduced as of January 1, 2003 to 35%, 33%, 28%, and 25% respectively. This represents a drop in rates of 9.3%, 5.7%, 6.7% and 7.4% respectively.

- The amount of income exempt from the alternative minimum tax will be raised by $7,500 (for single individuals and married individuals filing separately) or $15,000 (for married couples filing jointly) for 2003 and 2004.

- Under the terms of the 2001 Act, none of these provisions will apply for taxable years beginning after December 31, 2010.

Capital Gain and Dividend Rate Reductions

- Once enacted, the Bill will reduce the top rates imposed on long-term capital gain from 20% to 15%. There is no rate reduction for short-term capital gain, which will continue to be taxed at ordinary income tax rates. These rate reductions will be effective for taxable years ending on or after May 6, 2003 and beginning on or before December 31, 2008. For the current year, the lower rates will apply only to long-term capital gain realized after May 6, 2003.

- Under the Bill, "qualified dividend income" received by individuals will be taxed at the reduced long-term capital gain rates described above. Like the reduction in long-term capital gain rates, the reduction in the rate at which a dividend is taxed will not apply after December 31, 2008.

- The reduction in the tax rate on dividends from 38.6% to 15% (a 61.1% reduction) will create many planning opportunities for pulling dividends out of companies (from operations or through leveraged recapitalizations).

    - Qualified dividend income is defined as dividend income (whether paid out of current or accumulated earnings and profits) received from domestic corporations and qualified foreign corporations. A foreign corporation is a qualified foreign corporation if it is (i) incorporated in a possession of the U.S., or (ii) eligible for the benefits of a comprehensive income tax treaty with the U.S. Dividends on stock of a foreign corporation "readily tradable on an established securities market in the U.S." will be treated as qualified dividend income. Dividends from foreign personal holding companies, foreign investment companies, and passive foreign investment companies will not be qualified dividend income.

    - Qualified dividend income does not include any dividend received on a share of stock (i) held for less than 60 days during the 120 day period beginning 60 days before the stock becomes ex-dividend or (ii) to the extent the taxpayer has hedged his position in the stock.

    - Qualified dividend income will only be included in "investment income" (for purposes of the limitation on deductibility of investment interest) to the extent an election is made to subject such dividend income to ordinary income tax rates. If a taxpayer makes this election, the dividends will no longer be qualified dividend income.

    - If a shareholder receives qualified dividend income from "extraordinary dividends" on his shares (basically, a dividend or dividends representing over 10% (5% in the case of preferred shares) of the shareholder's basis in the shares) any loss on the sale of the shares will be treated as long-term capital loss. This prevents a taxpayer from taking dividend income into account at 15% and then selling at a short-term capital loss to offset other ordinary income (at rates of up to 35%).

    - Capital gain dividends paid by a regulated investment company ("RIC") are taxed at the reduced long-term capital gain rates, and are not considered qualified dividend income. In addition, unless dividends received by a RIC constitute 95% or more of a RIC's gross income, only the portion of the dividend designated by the RIC as being paid out of qualified dividends received by the RIC will be considered qualified dividend income at the shareholder level. Similar pass-through rules apply to dividends paid by a real estate investment trust ("REIT"). A transition rule provides that only dividends received by the RIC or REIT after December 31, 2002 are eligible for pass-through treatment.

Growth Incentives for Businesses

- Once enacted, the Bill will extend and increase the special depreciation allowance created by the 2002 Act. For most new depreciable business property acquired after September 10, 2001 and before September 11, 2004 the 2002 Act provides a depreciation deduction of 30% of the cost of the property in the year the property is placed in service. This first year bonus depreciation will be increased to 50% for property that is acquired after May 5, 2003 and before January 1, 2005 and that is placed in service before January 1, 2005. In addition, the Bill provides that the "placed in service" date for property eligible for 30% bonus depreciation under the 2002 Act will be extended to January 1, 2005. See Tax & Benefits Department Memorandum 2002-3 for more detail on these provisions.

- Under present law, certain businesses with a sufficiently small amount of annual investment may elect to deduct each year up to $25,000 of the cost of depreciable business property. The $25,000 amount is phased out if more than $200,000 of depreciable business property is placed in service during the taxable year. Once enacted, the Bill will increase the deductible amount to $100,000 and the phase-out amount to $400,000 for property placed in service in taxable years beginning in 2003, 2004 and 2005. The Bill also provides that "off-the-shelf computer software" placed in service through January 1, 2005 will be eligible for 50% bonus depreciation.

Contact Information

Please consult a member of the Tax & Benefits Department with any questions.