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## **A Brief Look at the 2003 Tax & Relief Act**

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.

### **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, netting an additional \$1,200 return.

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.



## Increased Business Expensing Allowance and Bonus Depreciation

One provision retroactively increases the “**Section 179 expensing**” limitation to **\$100,000** (from \$25,000) and the phase-out range to \$400,000 (from \$200,000). Also, this provision expands the category of eligible property—generally defined as tangible property other than real estate, such as machinery and equipment—to include off-the-shelf computer software.

Thus, for taxable years beginning after December 31, 2002, an eligible small business may deduct up to \$100,000 of the cost of qualifying property, provided the total cost of all such property does not exceed \$400,000. The \$100,000 and \$400,000 amounts will be adjusted for inflation in taxable years beginning in 2004 and 2005. The law is scheduled to revert to the old rules, however, in taxable years beginning after December 31, 2005.

The other incentive provision increases “bonus” first-year depreciation to 50% (from 30%) for certain property acquired and placed in service after May 5, 2003, and before January 1, 2005. The placed-in-service date is extended by one year for self-constructed property.

Both of these provisions have numerous details that must be taken into account in determining the consequences of any specific transaction. Professional advice is a must for any business contemplating a transaction that might be affected by these rules. Our office is prepared to help you develop and implement your plans.

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