

Client Alert

A report
for clients
and friends
of the firm June 2003

The Jobs and Growth Tax Relief Reconciliation Act of 2003

On May 28, 2003, President Bush signed into law the Jobs and Growth Tax Relief Reconciliation Act of 2003 ("the Act"). The Act contains sweeping changes to the tax law, including reduced capital gains and dividend tax rates, increased depreciation and expensing allowances for certain qualified business property, delayed payment of a portion of third quarter 2003 corporate estimated taxes, an acceleration of previously enacted personal income tax rate reductions, and other miscellaneous tax provisions.

Capital Gains and Dividend Tax Rate Reductions

Reduced Individual Capital Gains Tax Rates

The Act substantially reduces capital gains and dividend tax rates for individuals. Under prior law, the maximum individual tax rate on long-term capital gains (tax due from the sale of a capital asset held for more than one year) was 20% and was as low as 10% for certain lower tax brackets.

The Act reduces the 20% tax to 15% through 2008 and reduces the 10% tax to 5% through 2007. The 5% rate is reduced to 0% for 2008. The new capital gains tax rates are effective for sales, exchanges and payments received after May 5, 2003, and through December 31, 2008. The committee report indicates that these lower rates also apply to installment sales payments received after May 5, 2003 and in later years from pre-2003 installment sales. These lower rates apply to both the regular Federal income tax and the alternative minimum tax (the "AMT"). The rates sunset on December 31, 2008.

Dividend Relief for Individuals

Under prior law, dividends received by an individual were taxed as ordinary income at rates up to 38.6%. The Act reduces an individual's tax rate on dividends that are paid from domestic and "qualified" foreign corporations to 15% and 5% (the 5% rate is reduced to 0% in 2008 for individuals in lower tax brackets).

Qualified foreign corporations are foreign corporations that are (i) incorporated in a U.S. possession or (ii) eligible for benefits of a comprehensive U.S. income tax treaty. Qualified foreign corporations also include foreign corporations that pay a dividend on stock that is readily tradable on an established U.S. securities market.

Similar to the capital gains rate reductions, these lower dividend tax rates apply to both the regular Federal income tax and the AMT. The reduced rates apply to dividends received in tax years beginning January 1, 2003 and ending on December 31, 2008. These reduced rates sunset on December 31, 2008.

The reduced rates are not available to individual shareholders who receive dividends for which the holders are obligated (pursuant to a short sale or otherwise) to make related payments on positions in substantially similar or related property. In addition, individuals are not eligible for the reduced rates if they do not hold the dividend producing stock for more than 60-days during the 120-day period beginning 60-days from the ex-dividend date.

Dividends From REITs and RICs

If a real estate investment trust ("REIT") or a regulated investment company ("RIC") receives dividends after December 31, 2002 that qualify for the reduced rates and that are, in the aggregate, less than 95% of its gross income (as specially computed), the REIT or RIC can pay dividends that qualify for the reduced dividend rates to their shareholders only to the extent of the amount of qualifying dividends that the REIT or RIC received. In the case of dividends paid by a REIT to its shareholders, qualifying dividends

that are eligible for the reduced rates include the excess of the REIT's income on which it paid a Federal corporate level tax for the preceding tax year, minus the amount of the corporate level taxes that it paid during such year.

Accumulated Earnings Tax and PHC Tax

The accumulated earnings tax and the personal holding company tax are reduced to 15%.

Extraordinary Dividends

The Act also modifies the tax treatment for section 1059(c)¹ extraordinary dividends (dividends paid on common stock that equal or exceed 10% of the shareholder's basis in the stock or dividends paid on preferred stock that equal or exceed 5% of the shareholder's basis in the stock). If an individual receives section 1059(c) extraordinary dividends that are eligible for the reduced rates on any share of stock, any loss on the individual's sale of the stock will be long-term capital loss, to the extent of the dividend.

Section 306 Stock

Amounts treated as ordinary income from the disposition of section 306 stock are subject to tax at the reduced dividend tax rates.

Increased Depreciation and Section 179 Expensing

Special Depreciation Allowance

Prior law permitted taxpayers an additional first year depreciation deduction equal to 30% of the adjusted basis of qualified property. This percentage is now increased to 50%. To qualify for the 50% additional depreciation deduction, the property must be acquired after May 5, 2003 but before January 1, 2005. However, property acquired pursuant to a binding written contract that was in effect before May 6, 2003 will not qualify for this depreciation benefit. In addition, taxpayers may not utilize both the 30% and the 50% depreciation benefits for the same property. The provision is effective for taxable years ending after May 5, 2003.

Increased Section 179 Expensing

Beginning in 2003, section 179 permitted certain taxpayers to deduct, in lieu of depreciating, up to \$25,000 of the cost of qualifying property placed into service during taxable year. Qualifying property generally was defined as depreciable tangible personal property purchased for use in the active conduct of a trade or business. The \$25,000 amount was phased out if the cost of qualifying property exceeded \$200,000.

The Act increases the \$25,000 expense amount to \$100,000 for property placed into service during 2003, 2004 or 2005. In addition, for these years, the \$200,000 phase-out amount is increased to \$400,000. The increased section 179 expensing amount also applies to off-the-shelf computer software placed into service during 2003, 2004 or 2005. Taxpayers may make or revoke expensing elections on amended Federal income tax returns without IRS consent for these years.

Corporate Estimated Taxes

Under prior law, calendar tax-year corporations made estimated Federal income tax payments by April 15, June 15, September 15 and December 15. Under the Act, 25% of the amount of any estimated corporate payments due on September 15, 2003, is not due until October 1, 2003.

Personal Federal Income Tax Rate Reductions

Reduction of Regular Income Tax Rates

Prior to the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), the regular income tax rate brackets were 15%, 28%, 31%, 36% and 39.6%. EGTRRA created the 10% and 15% income tax brackets and the then effective 28%, 31%, 36% and 39.6% rates were reduced to 25%, 28%, 33% and 35%, respectively, over a six year period.

Effective as of January 1, 2003, the individual regular income tax brackets of 27%, 30%, 35% and 38.6% are reduced, respectively, to 25%, 28%, 33%, and 35%. These lower rates will sunset on December 31, 2010 at which time the rates will return to 28%, 31%, 36%, and 39.6%.

The following table summarizes the evolution of the individual regular income tax rates from 2000 through 2011.

Year		Regular Income Tax Rates				
2000	----	15%	28%	31%	36%	39.6%
2001	10%	15%	27% ²	30% ²	35% ²	38.6% ²
2002	10%	15%	27%	30%	35%	38.6%
2003	10%	15%	25%	28%	33%	35.0%
...	10%	15%	25%	28%	33%	35.0%
2010	10%	15%	25%	28%	33%	35.0%
2011	----	15%	28%	31%	36%	39.6%

¹ All section references are to the Internal Revenue Code of 1986, as amended. ² Effective July 1, 2001.

AMT Exemption Amounts

An individual's tentative AMT is (1) 26% of the first \$175,000 (\$87,500 in the case of a married individual filing a separate return) of AMT income in excess of a specified exemption amount and (2) 28% of the remaining AMT income. The Act increases the AMT exemption from \$49,000 to \$58,000 for married taxpayers filing joint returns and surviving spouses, and from \$33,750 to \$40,250 for unmarried taxpayers, for 2003 and 2004. These increased exemption amounts sunset on December 31, 2004.

10% Regular Income Tax Rate

Under prior law, the 10% income tax bracket applied to the first \$6,000 of taxable income for single individuals, \$10,000 of taxable income for heads of households, and \$12,000 for married couples filing joint returns. Under the Act, the 10% income tax bracket is expanded to \$7,000 for single individuals and to \$14,000 for married couples filing joint returns, for 2003 and 2004. The 10% income tax bracket remains unchanged at \$10,000 for head of households. These changes in the 10% income tax rate bracket revert to prior law after December 31, 2004.

Miscellaneous Tax Changes

The Act also provides relief from the "marriage penalty," increases child credit benefits, and provides States with certain benefits in addition to other miscellaneous tax changes.

The full text of the Act along with its accompanying Conference Report can be found at:

http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_cong_reports&docid=f:hr126.108.pdf

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