INFORMATION PAPER

DAJA-LA
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Subject: The Jobs And Growth Tax Relief Reconciliation Act Of 2003 (JGTRRA)

1. Purpose**:** To provide information on the benefits for individual taxpayers under the JGTRRA and provide practice tips for military tax assistance providers.

2. Discussion:

a. JGTRRA introduces new rules and accelerates benefits enacted 2 years ago under the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 through retroactive, temporary, and phased-in/phased-out effective dates. Highlights of JGTRRA include:

1) Increase in Child Tax Credit. For 2003 and 2004, the amount of the child tax credit increases to $1000 per child (from $600 per child in 2002).

a) Impact: The 2001 tax relief act (EGTRRA) called for a phase-in of this increase during the 2005 through 2010 period. Now, in 2003 and 2004, taxpayers with qualifying children will receive a $1000 credit per child. During Jul and Aug 03 the Treasury sent advance payments of up to $400 per child of the 2003 child tax credit. The total amount of the advance payment was based on the taxpayers' 2002 filing status, income, and the number of children claimed in the 2002 income tax return who remain under 17 in 2003. Of note, eligibility for this increased credit does not extend to many lower income families -- those taxpayers whose child tax credit and additional child tax credit for 2002 totaled less than $600 for each qualifying child because of the minimum tax liability and earned income limitations. Phasing out of eligibility for the child tax credit at certain modified adjusted gross income levels remains unchanged: $110,000 for married filing jointly, $55,000 for married filing separately, and $75,000 for single filers. The total credit -- not the per child amount -- for which a taxpayer is eligible falls $50 for every $1000 the adjusted gross income exceeds these thresholds.

b) Practice Tip: The $400 per child payments are advance payments on the 2003 child tax credit to which taxpayers will be entitled when they file their 2003 federal income tax returns. Those receiving the advance will only be able to claim the remaining $600 per child for the child tax credit when they file their 2003 federal income tax return. As the information to make this advance payment calculation comes from the 2002 income tax returns, taxpayers who have or adopt a child in 2003 will NOT receive an advance payment. Assuming they do not exceed the adjusted gross income ceiling or fall below the minimum tax liability and earned income limitations, they will qualify for the full $1000 child tax credit for the new child when they file their 2003 income tax return.

c) Timeline: The child tax credit increase under JGTRRA applies only for 2003 and 2004. In 2005, the credit is scheduled to fall to $700 per child, increasing to $1000 per child by 2010, under the 2001 EGTRRA schedule.

2) Marriage Penalty Relief. JGTRRA increases the standard deduction for married couples filing jointly to twice the amount of the standard deduction for single taxpayers, eliminating part of the so-called marriage penalty. However, this relief endures for only 2 years - 2003 and 2004.

a) Impact: Before JGTRRA, the 2003 standard deductions were set at $4750 for single filers, $7950 for married filing jointly, $7000 for heads of household, and $3975 for married filing separately. JGTRRA increases the deduction for married filing jointly to $9500. Also, the standard deduction for married taxpayers filing separately is eliminated. These taxpayers will use the standard deduction for single filers in 2003 and 2004. For 2003, married taxpayers filing separately will thus boost to a standard deduction of $4750 from $3975.

b) Practice Tip: The increased standard deduction will influence married filers' decisions on whether to itemize or use the now increased standard deduction. The rules of the state in which the taxpayer files must also factor into this decision. Some states require parity with the federal income tax return, permitting itemizing on the state return only when itemized deductions are taken on the federal return. Tax assistance providers must consider whether taking the standard deduction or itemizing deductions will generate the most tax savings overall, at the federal and state levels.

c) Timeline: Limited to 2003 and 2004. In 2005, the standard deduction for married couples filing jointly falls to 174% of the standard deduction for single taxpayers, then gradually increases over the following years to return to double the standard deduction for single filers by 2009.

3) Reduced Capital Gains Tax Rate**.** JGTRRA immediately cuts the long-term capital gains tax rate five percentage points from 20 to 15%. The current 10% capital gains rate for lower-income taxpayers - those in the 10% and 15% ordinary income tax brackets - falls to 5%. These reduced rates apply to sales and exchanges of capital assets, including real estate, on or after 6 May 03 through 31 Dec 07. The long-term capital gains tax rate for lower-income taxpayers falls to 0% for 2008 only. Each of these rate reductions is temporary, ending in 2008. Of note, the special reduced rates on capital assets owned for 5 years or more are eliminated under JGTRRA. Formerly, an 18% and 8% capital gains tax rate applied to this so-called "5-year property." The

new rates are limited to 15% and 5% and taxpayers do not get a further 2 percentage point cut for property owned 5 years or more. Effective 1 Jan 09, the 18% and 8% rates on "5-year property" return with the restoration of the pre-JGTRRA 20% and 10% capital gains tax rates.

a) Impact: The capital gains tax rate does not apply "across the board." The reduced rates apply only to long-term capital gains -- those resulting from sales or exchanges of capital assets owned for 1-year or more. There is no reduction of the tax rates applicable to short-term capital gains. Additionally, the long-term capital gain from sale of some assets, such as collectibles, remains at 28%. Deduction of capital losses against ordinary income continues to be limited to $3000 per year for individual taxpayers. However, the reduced rates should assist military taxpayers who sell a home they've used as rental property and who fail to qualify for the exclusion of capital gain connected with the sale of a principal residence.

b) Practice Tip: Exercise care if you assist a taxpayer reporting capital gains or losses in 2003. The 6 May 03 effective date will add complexity and cause confusion. The IRS reports 8 lines will have to be added to Schedule D, the Schedule D Worksheet, the Form 6251 (used to calculate the alternative minimum tax), and the Form 8801 (Credit for Prior Tax Year). Additionally, taxpayers whose only capital gains are capital gain distributions will not be able to use the shorter worksheet for Forms 1040 and 1040A. They will have to use the Form 1040 with Schedule D attached. The IRS predicts up to 6 million taxpayers could be so impacted. The termination of the "5-year property" capital gains tax rate may create problems for taxpayers who made a "deemed sale election" effective 1 Jan 01 to allow property to qualify for the 18% and 8% rates. Be aware of the limits of your competence to provide advice in these areas.

c) Timeline: The 15% long-term capital gains tax rate terminates on 31 Dec 08. Lower-income taxpayers maintain the 5% rate through 31 Dec 07, then benefit from a 0% tax rate in 2008 on the long-term capital gains covered by the JGTRRA reductions. The pre-JGTRRA rates return on 1 Jan 09 - 20% for most taxpayers, 10% for lower income taxpayers, with the 18% and 8% rates respectively applied to capital assets owned 5 years or more.

4) Reduced Dividend Tax Rate. Under JGTRRA, most taxpayers who own stock will see their dividend income received from a domestic or qualified foreign corporation taxed at a maximum rate of 15%. Lower-income taxpayers will pay tax on their stock dividends at a new rate of 5%. As with the reduction in the capital gains tax rates, this tax relief is temporary.

a) Impact: Under pre-JGTRRA law, stock dividends were taxed as ordinary income. Those rates ranged from as little as 10% to as high as 38.6%. Now, most taxpayers will pay not more than 15%, a substantial cut. Lower-income taxpayers -- again those in the 10% and 15% ordinary income tax brackets -- will be taxed at only 5% on dividends. Complexity will derive from determining which types of dividends qualify for this relief. Certain types of dividend income are specifically excluded in recognition of the fact they are not taxed at the corporate level.

b) Practice Tip: In general taxpayers receiving dividend payments on stock in most corporations operating for profit will benefit from this relief.

c) Timeline: The 15% dividend tax rate terminates on 31 Dec 08. The 5% rate falls to 0% for 2008 only. Effective 1 Jan 09, the pre-JGTRRA rates resume, unless Congress acts in the interim to extend the JGTRRA rates and enact new ones.

5) Accelerated Marginal Tax Rate Cuts. JGTRRA accelerates the individual marginal tax rate cuts that were not scheduled to take effect until 2004 and 2006 under the EGTRRA of 2001. Rates above 15% will generally decline about 2 percentage points. The highest rate, formerly 38.6%, drops 3.6 percentage points.

a) Impact: The marginal tax rates for 2003 had been 10%, 15%, 27%, 30%, 35%, and 38.6%. Retroactive to 1 Jan 03, the new rates are 10%, 15%, 25%, 28%, 33%, and 35%. These reductions will benefit married couples with taxable income greater than $47, 450, and single taxpayers with taxable income greater than $28,400.

b) Practice Tip: Because the rate cuts are retroactive to 1 Jan 03, taxpayers will be able to reduce the amounts they have withheld from their paychecks to reflect both the prospective and retroactive nature of the tax cuts. Alternatively, if they maintain their current withholding exemptions, taxpayers who might have owed taxes may now receive a refund while those who usually receive a refund can look forward to a larger one than they would have received had the tax rates not been cut.

c) Timeline: Although the cuts in marginal rates do not have termination provisions under JGTRRA, they will terminate as of 1 Jan 09 under the EGTRRA of 2001.

6) Expanded 10% and 15% Tax Brackets**.** Along with the accelerated tax rate cuts noted above, JGTRRA raises the taxable income level for the 10% tax bracket that would otherwise not have taken effect until 1 Jan 08. For single filers, the income threshold for the 10% bracket increases to $7000. For married couples who file jointly, the income threshold increases to $14,000. This relief is temporary. JGTRRA also expands the income range of the 15% tax bracket for married couples filing jointly to twice that of the same bracket for single filers. This relief is also temporary.

a) Impact: The 10% rate applies to all taxpayers, irrespective of the marginal tax rates applicable to increasing income amounts. Thus, every single filer paying taxes at a marginal rate above the 10% bracket will receive a tax benefit of $50 and every joint filer will receive a $100 benefit. All tax brackets will be adjusted annually for inflation, maintaining the practice traditionally applicable to brackets above 10%. The 10% bracket will be indexed for inflation for the first time starting in 2004, accelerating the 2001 EGTRRA schedule that waited until 2007 to index this lowest tax bracket for inflation.

b) Practice Tip: Many married taxpayers will find continuing to itemize deductions remains the best option for tax savings, despite the increase in the standard deduction and partial elimination of the “marriage penalty” for married couples filing jointly. These clients may believe the new tax law does not extend them relief. However, in addition to the $100 benefit resulting from expansion of the 10% bracket (noted above), married couples filing jointly and itemizing deductions will gain some relief as a result of the expanded 15% bracket. The expanded bracket will capture more married couples at the 15% level and will affect the income ranges for the higher brackets, moving some married couples to a lower marginal tax rate. One potential downside of these effects -- more taxpayers may become liable for the alternative minimum tax (AMT).

c) Timeline: The expansion of the 10% bracket to a maximum of $7000 in taxable income for single filers and $14,000 for married couples filing jointly endures for 2003 and 2004 only. The previous thresholds of $6000 for single filer and $12,000 for married filing jointly return in 2005. Because of the 2001 EGTRRA, the $7000 and $14,000 respective thresholds return effective 1 Jan 08. Relief is also temporary with the expanded 15% tax bracket for married couples filing jointly. The maximum taxable income of that bracket remains twice the maximum income level of the same bracket for single filers only during 2003 and 2004. After 2004, the 15% tax bracket for married couples filing jointly falls to 180% of the maximum taxable income for the same bracket for single filers.

b. More guidance on these tax changes will be provided during the Tax Courses and will be posted on JAGCNET.

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