

## **How the new law affects individuals and investors right now**

I'm sure you've heard or read about passage of the Jobs and Growth Tax Relief Reconciliation Act of 2003, and the political controversy it has stirred up. Naturally, the first question in your mind is: "how am I affected by this new law?" That's the purpose of this letter. It highlights how the new law will cut your tax bill for 2003. It also gives you an idea of the changes that are in store for future years, and why tax and financial planning has become more complex than ever before.

Your income will be taxed at lower rates. For regular tax purposes, the first "slice" of your taxable income is taxed at 10%, and additional slices of taxable income are taxed at progressively higher rates until you reach the maximum rate. The various "slices" of taxable income, and the tax rates each is subject to, are commonly referred to as the "tax brackets." All of the following changes apply retroactively to Jan. 1, 2003:

- If you file as a single person or are a married person filing separately from your spouse, the first \$7,000 (instead of \$6,000) of your taxable income will be taxed at 10%, the lowest tax rate. Because the extra \$1,000 was taxed at 15% under prior law, you save a maximum of \$50.
- If you file a joint return, the first \$14,000 (instead of \$12,000) of your taxable income will be taxed at 10%, the lowest tax rate. Because the extra \$2,000 was taxed at 15% under prior law, you save a maximum of \$100.
- If you file a joint return, more of your taxable income will be taxed at 15% (instead of winding up in the next highest tax bracket and being taxed at 25%).
- The new law reduces all of the tax rates above 15% for all individuals (as well as estates and trusts). The new tax rates above 15% are: 25% (instead of 27%), 28% (instead of 30%), 33% (instead of 35%) and 35%, the top rate (instead of 38.6%).

How much will all of these changes save you? The answer depends on how much taxable income you have and your filing status. For example:

- If you are single with \$60,000 of taxable income for 2003, your tax bill will be \$682 less. If your taxable income is \$120,000, you save \$1,882.
- If you are married, file a joint return and have \$60,000 of taxable income for 2003, your tax bill will be \$1,286 less. If your taxable income is \$120,000, you will save \$2,486.

The tax savings will be higher if taxable income includes dividends or capital gains (taxed at a lower rate under the new law, see below). Additional tax savings will be realized if the individual is entitled to an enhanced child tax credit.

Wage-earners will get a larger paycheck as a result of these (and other) changes for individuals. The IRS says payroll withholding will reflect the new law as soon as employers and payroll processors put new withholding tables into effect.

### **Bigger standard deduction for joint filers.**

If you are married, file a joint return, and don't itemize your deductions, your basic standard deduction for 2003 is \$9,500, a \$1,550 increase. There's no increase in the additional standard deduction amounts for elderly and blind persons.

### **Bigger alternative minimum tax (AMT) exemptions.**

The alternative minimum tax, which is payable only if it exceeds your regular tax bill, is a hazard because many tax breaks ("preferences") allowed for purposes of calculating regular taxes are disallowed for AMT purposes. The "preferences" are added back to regular taxable income, an AMT exemption amount (which phases out at higher income levels) is subtracted, and the balance is subject to an AMT rate of 26% or 28%. The new law makes the AMT less of a problem by increasing the maximum AMT exemption amount to \$58,000 for marrieds filing jointly (a \$9,000 increase), to \$40,250 for unmarried individuals (a \$4,500 increase), and to \$29,000 for married individuals filing separate returns (a \$4,500 increase).

### **Boosted child tax credit, partially refundable for 2003.**

The child tax credit for 2003 is \$1,000 per qualifying child (a \$400 increase over the prior-law \$600 amount). What's more, the increased amount of the child tax credit will be paid "in advance" beginning in mid-July over a period of three weeks. This year, a qualifying family with one child will receive an advance payment check from the Treasury for up to \$400, and a qualifying family with two children will receive a check for up to \$800. The amount of advance payments will be based on a person's 2002 filing status and income, as well as the number of children claimed on the 2002 tax return who will still be under age 17 in 2003. Note that the new law didn't change the income levels at which the child credit starts to phase out (\$75,000 for singles, \$110,000 for married couples, and \$55,000 for marrieds filing separately).

### **Reduced taxes on capital gains and dividends.**

For sales and exchanges (and installment payments received) after May 5, 2003, gains on most capital assets held longer than one year will be taxed a maximum rate of 15% (instead of 20%). The maximum tax rate on capital gains drops to 5% (instead of 10%), if it would otherwise be taxed at 10% or 15% (because of the individual's particular tax bracket). In addition, dividends you receive in 2003 from a domestic corporation (or certain "qualified foreign corporations") are taxed at the same rates that apply to capital gains. In other words, the dividends are taxed at rates of 15% or 5%. These new capital gain and dividend rates apply for both the regular tax and the AMT.

### **What the future holds in store.**

Unfortunately, to meet budget constraints many of the tax breaks in the new law are not permanent. For example, unless Congress changes the rules again, the new tax breaks for

marrieds filing jointly (more income taxed in the 15% tax bracket instead of a higher tax bracket, and larger basic standard deduction) are slated to be watered down after 2004, the AMT exemption amounts will drop after 2004, and the maximum child tax credit also will drop after 2004. What's more, the reduced tax rates for capital gains and dividends will only last through the end of 2008. This will make it much harder for all of us to plan for the long haul.

Our first step should be to examine the new law's immediate effect on you, your family, and your investments, and then come up with a game plan for the future. Please call our offices to set up an appointment.