

A CLOSER LOOK AT THE IMPACT ON BUSINESSES

A. Closer Look at the Impact on Businesses - Tax Rate Cuts Help Businesses, Too

- Tax rate reductions help noncorporate business owners
- The top rate has been reduced from 38.6% to 35%, the 35% rate has been reduced to 33%, the 30% rate has been reduced to 28%, and the 27% rate has been reduced to 25%
- The maximum tax rate on capital gains has been reduced to 15%

B. Good Time to Buy Business Equipment

- The new tax law is intended to encourage businesses to purchase business equipment
- Businesses can take a current deduction for their purchases by taking advantage of the increased dollar limitation on expensing property and 30% or 50% first-year bonus depreciation

C. Equity Financing More Attractive

- As a result of the new tax law, businesses will find equity financing relatively more attractive than debt financing because interest is taxed at a much higher tax rate than dividends to potential investors

D. Increased Dollar Limitation for Expensing Section 179 Property

- Instead of recovering the cost of property through depreciation deductions over a number of years, taxpayers may elect to deduct all or a portion of the cost of new or used depreciable tangible property purchased for use in a trade or business
- The aggregate amount that may be expensed each year has been increased from \$25,000 to \$100,000 for tax years beginning in 2003, 2004, and 2005 (but will return to \$25,000 for subsequent years)
- The \$100,000 dollar amount will be adjusted for inflation in 2004 and 2005

E. Reduction in the Investment Limitation on the Cost of Property That Can Be Expensed

- The dollar limitation on expensing has to be reduced by the amount by which the cost of qualifying property placed in service during the year exceeds a specified amount
- The point at which the annual dollar limitation has to be reduced has been increased from \$200,000 to \$400,000 for tax years beginning in 2003, 2004, and 2005 (and will return to \$200,000 for subsequent years)
- The \$400,000 amount will be adjusted for inflation in 2004 and 2005

F. Revocation of Section 179 Election to Expense Property

- Before the new tax law, a Section 179 election to expense property could not be revoked without the IRS's permission
- Under the new tax law, an election to expense property may be revoked for any tax year beginning during, 2003, 2004, and 2005
- A revocation, once made, is irrevocable

G. Bonus Depreciation Changes

- Extension of 30% bonus depreciation
- Additional 50% bonus depreciation
- Additional first-year depreciation for luxury cars

H. Expensing Off-the Shelf Computer Software

- Off-the-shelf computer software can be expensed for tax years beginning in 2003, 2004, or 2005

I. Planning Opportunity: Picking Which Assets to Expense

- The new tax law's increase to \$100,000 of the amount of assets that can be expensed makes the strategy of picking particular assets to expense even more worthwhile
- Usually, it is best to expense assets with the longest recovery period (i.e., the number of years over which property must be depreciated if not expensed)

J. Extension of Additional First-Year Depreciation Deduction (30% Bonus Depreciation)

- Taxpayers may recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income
- The Job Creation and Worker Assistance Act of 2002 has allowed taxpayers an additional first-year depreciation deduction equal to 30% of the adjusted basis of qualified property
- The new tax law has extended the availability of 30% bonus depreciation to property acquired on or after September 11, 2004 but before 2005

K. Qualified Property Eligible for Bonus Depreciation

- To be *qualified property*, property generally must be new (not used) and have a recovery period of 20 or fewer years
- The property must be acquired before January 1, 2005; acquired pursuant to a written binding contract that was entered into before January 1, 2005; or, if it is to be manufactured, constructed, or produced for the taxpayer's own use, the taxpayer must begin its manufacture, construction, or production before January 1, 2005
- *Qualified property* must be placed in service before January 1, 2005 (January 1, 2006 if the property has a long production period)

L. Additional First-Year Depreciation Deduction (50% Bonus Depreciation)

- Taxpayers who acquire 50% bonus depreciation property may increase their first-year depreciation deduction by 50% of their adjusted basis in the property
- *50% bonus depreciation property* is qualified property whose original use commences with the taxpayer after May 5, 2003 and which is acquired by the taxpayer after May 5, 2003 and before January 1, 2005 (but only if no binding contract for its acquisition was in effect before May 6, 2003). If 50% bonus depreciation property is to be manufactured, constructed, or produced for the taxpayer's own use, the taxpayer must begin its manufacture, construction, or production after May 5, 2003 and before January 1, 2005.

M. Heavy SUVs Not Subject to Limit on Depreciation

- Businesses still may fully depreciate SUVs and other vehicles weighing more than 6,000 pounds that they use in business
- Attempts to treat SUVs as luxury automobiles subject to the limitation on depreciation deductions failed

N. Bonus Depreciation Applies to Property Received in a Like-Kind Exchange or Involuntary Conversion

- The Conference Report on the new tax law has made it clear that taxpayers may take bonus depreciation on property received in a like-kind exchange or involuntary conversion

O. Additional First-Year Depreciation for Luxury Cars

- The first-year limitation on the depreciation deduction for luxury passenger automobiles that qualify for 30% bonus depreciation is increased by \$4,600 (not indexed for inflation) to \$7,660
- The first-year limitation on the depreciation deduction for luxury passenger automobiles that are 50% bonus depreciation property is increased by \$7,650 (not indexed for inflation) to \$10,710

P. Electing Not to Take Bonus Depreciation

- Taxpayers may elect to take 30% bonus depreciation instead of 50% bonus depreciation for any class of property
- Taxpayers may elect not to take 30% bonus depreciation for any class of property

Q. Window of Opportunity for Withdrawing Earnings

- Business owners who have been reluctant to withdraw earnings from their business because of the high tax previously imposed on dividends may want to do so before 2009
- Business owners who had been relying on compensation to reduce corporate-level tax may want to increase dividends and use other expenses to reduce corporate-level tax
- After 2008, dividends once again will be taxed as ordinary income

R. Personal Holding Company Tax Reduced

- The personal holding company tax, applied to undistributed personal holding company income, has been reduced
- The tax rate has been reduced from 38.6% in 2002 (The highest rate of tax on single individuals) to 15%

S. New Advantage for ESOPs

- If taxpayers receive employer securities in a lump sum distribution from an employee stock ownership plan (ESOP), the net unrealized appreciation will be taxed at the reduced capital gains tax rate when the securities are sold
- However, dividends paid on employer stock held by an ESOP do not qualify for the reduced tax rate on dividends

T. Accumulated Earnings Tax Reduced

- The accumulated earnings tax, applied to corporations that accumulate an unreasonable amount of earnings instead of distributing the earnings as dividends, has been reduced
- The tax rate has been reduced from 38.6% in 2002 (the highest rate of tax on single individuals) to 15%

U. Collapsible Corporation Rules Repealed

- The new tax has repealed the rule treating gain from the sale or exchange of collapsible corporation stock or a liquidating distribution from such a corporation as ordinary income instead of capital gain
- A *collapsible corporation* is a corporation formed or availed of principally for the manufacture, construction, or production of property with a view to selling or exchanging the corporation's stock and realizing capital gain before the corporation has realized 2/3 of the income to be derived from the property

V. Don't Overlook Section 83(b) Elections

- When restricted stock or other property is transferred in connection with the performance of services, the person who performs the services has to include the fair market value of that property in gross income when his or her rights become transferable or no longer subject to a substantial risk of forfeiture
- By making a Section 83(b) election, the value of the property has to be included in gross income, but any subsequent appreciation will be taxed at the reduced capital gains rate

W. Alternative Minimum Tax Relief for Sales of Small Business Stock

- When qualified small business stock is sold, half of the gain may be excluded from gross income, but a portion of the excluded gain is subject to the alternative minimum tax
- The portion of excludable gain from the sale of qualified small business stock that has to be included in alternative minimum taxable income has been reduced from 42% to 7% for dispositions on or after May 6, 2003

X. Incentive for Corporations to Redeem Shares Rather Than Pay Dividends Has Been Reduced

- Taxing long-term capital gains and dividends at the same rate permits corporations to choose between paying dividends and repurchasing stock from shareholders based on economic merit
- The former rate differential encouraged corporations to repurchase shares (rather than pay dividends to help shareholders realize a return on their investment

Y. Due Date for September Corporate Estimated Tax Payment Delayed

- 25% of the amount of any required installment of corporate estimated tax that otherwise would be due in September 2003 will not be due until October 1, 2003