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Jobs and Growth Tax Relief Reconciliation Act of 2003 Tax Breaks for Business

Congress passed a new tax relief package just before Memorial Day, which in fact, turns out to be the third largest tax cut in U.S. history. Although much of the media focus has been on the tax breaks for families and investors in the *Jobs and Growth Tax Relief Reconciliation Act of 2003* (JGTRRA), the new law contains some very significant business tax breaks. JGTRRA's incentives will impact corporations, partnerships, S corps and other entities in every business endeavor.

Business highlights are:

- An increase in bonus depreciation to 50 percent for assets first put into service on or after May 6, 2003 and before January 1, 2005;
- A quadrupling of small businesses expensing from \$25,000 to \$100,000 for 2003, 2004, and 2005;
- Lower dividend and capital gains tax rates; and
- An extension of the deadline for filing third quarter 2003 corporate estimated taxes from September 15, 2003, to October 1, 2003.

Although business owners are always looking for a way to reduce their taxes, the passage of this new tax law is not just a time for celebration. It's also time for strategic planning. All of the tax breaks are temporary. In addition, the effective dates of the new tax cuts, and their sunset dates, are intertwined with the *Economic Growth and Tax Reconciliation Act of 2001* (EGTRRA) and the *Job Creation and Worker Assistance Act of 2002* (JCWA).

The new law may also impact your choice of business entity. Reducing individual marginal tax rates, while corporate rates stay the same, will tend to make partnerships and limited liability companies more attractive. At the same time, a maximum dividend tax rate of 15 percent combined with a top corporate rate of 35 percent leaves a potential 50-percent tax on income earned at the corporate level. The attractiveness of pass-through entities may depend on how successful corporations are in passing dividends through to shareholders. However, long-term planning is hindered by JGTRRA's sunset provisions.

Depreciation bonus. The increase in the depreciation bonus to 50 percent is an extension of JCWA's 30-percent first year depreciation bonus. The 50-percent bonus applies to property placed in service on or after May 6, 2003, and before January 1, 2005. The 50-percent bonus is on top of the regular first year depreciation. Extension of first year bonus depreciation should reduce business expenditures that would have been made this year to take advantage of the expiring 30-percent bonus.

Property does not qualify for the 50 percent level of bonus depreciation if its acquisition was the subject of a binding written contract entered into before May 6, 2003. Taxpayers cannot take JCWA's 30-percent and JGTRRA's 50-percent bonus on the same property at the same time. The new law also allows taxpayers to "elect out" of bonus depreciation. We can help you calculate the tax benefits of either taking or electing out of the bonus.

Small business expensing. JGTRRA increases the amount a small business can expense in a particular year from \$25,000 to \$100,000. For purposes of the phase-out of the deductible amount, the current \$200,000 ceiling is increased to \$400,000. Property must be placed in service in 2003, 2004, and 2005.

Combining bonus depreciation with increased expensing can generate some significant tax savings. Small business owners will tend to achieve the maximum benefit by expensing purchases of used assets, while saving bonus depreciation for purchases of new assets. In both cases, assets with longer depreciable lives generally should be selected first. Businesses need to act fast to take full advantage of bonus depreciation and increased expensing. You should review your current tax strategies. We can meet with you to go over your complete tax picture and help you determine how these new incentives can minimize your tax liability.

Dividend rate cut. The big question about the dividend tax rate cut is how will corporations respond? It appears likely that corporations will initiate or increase dividend payments in the hope of attracting capital, raising their stock price and, therefore, making it easier to attract equity capital. However, the six-year sunset provision may discourage corporations from moving quickly. Closely-held corporations, which traditionally extract funds in the form of compensation, rather than dividends, have new options. Compensation will still receive a corporate level deduction while dividends will not. However, compensation is taxed as high as 35 percent. Dividends, under the new law, will be taxed at 15 percent.

Marginal rate cuts. Unincorporated businesses will receive direct tax benefits from the decrease in marginal tax rates. The Treasury Department estimates that 80 percent of the benefit from the lowering of the highest marginal rate to 35 percent will go to business owners.

If your business is a traditional C corporation, the lowering of the individual marginal rates may trigger you to think about whether you want to convert your business to another business form, such as a partnership or S corp because the corporate tax rates are no longer a bargain compared to the individual rates. The change in the marginal rates will also mean that your business will have to conform its payroll practices to incorporate the lesser amounts required to be withheld from employees' paychecks.

You have many decisions to make in connection with the passage of this important new legislation. The amount of taxes that your business can potentially save by taking advantage of these provisions could enable you to undertake other projects or acquisitions. We can help you map out a strategy to deal with the new rules and their impact, as well as helping you make the most tax-savvy decisions so your business can grow.

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