

Supplement to Chapter 16 for the 2003 Jobs and Growth Act¹

Introduction

In May of 2003, Congress passed and President Bush enacted the 2003 Jobs and Growth Relief Reconciliation Act, P.L. 108-27, 108th Cong. 1st Sess. (2003 Act). The 2003 Act, which was billed as an economic stimulus plan, accelerated the tax rate reductions scheduled to occur in 2006, increased the child care credit from \$600 to \$1,000, reduced the tax rate on dividends and capital gains, mitigated the effects of the marriage penalty, and provided businesses with incentives to purchased depreciable property. The final product is roughly half of the over \$700 billion package the President originally proposed and did not include the total exclusion of dividend income from taxation requested by the President. After a partisan battle in Congress, moderate Republican Senators finally agreed to the scaled-down version that passed. Although the President touted the 2003 Act as an economic stimulus, it is unlikely to create much in the way of consumer spending since the most significant tax cuts flow to the wealthiest taxpayers.

As Robert Shapiro points out in “Will the Tax Cut Work? Here’s How We’ll Know if It Does,” *Slate*, June 10, 2003, available at <<http://slate.msn.com/default.aspx?id=2084135>> as of June 10, 2003, proponents of the 2003 Act used “fuzzy” math when they sold the economic benefits of the tax cuts.

... You can also measure the success of the tax act against the claims its proponents have made for it. Politicians typically overstate and oversell their proposals, so the administration probably does *not* want people to think about the cut this way. For example, the president has said that 91 million taxpayers will get an *average* tax cut of \$1,126 this year. But averages are deceiving when a small share of the people receives most of the benefits. In this case, the 83 percent of American households will get *less* than that average—including 50 million households that receive no tax relief at all and another 24 million that can expect \$100 or less—could judge it a failure, or at least a disappointment. The administration has also promised that the changes will create jobs, because 2 million small business owners receive an “average tax cut” of \$2,209 this year. Again, 83 percent of those with small-business income will receive much less—including more than one-third who get less than \$100—providing scant incentive or means to create jobs.

In the material that follows, we compare the new tax rate schedules for 2003 to the pre-2003 Act tax rate schedules, describe the marriage penalty mitigation provisions, discuss the increased child care credit, and explain how dividend income and capital gains will be taxed at preferable rates. The new depreciation rules are not examined.

A note of caution. The material presented below is not intended to be a comprehensive analysis of the 2003 Act. The material is intended to help students and instructors incorporate a few 2003 Act provisions into the material presented in Chapter 16.

Comparison of 2003 Tax Rate Schedules Before and After the 2003 Act.

SCHEDULE X: FILING STATUS—SINGLE: Tax Year 2003 Before the 2003 Act	
<u>Taxable Income</u>	<u>Tax</u>
Not over \$6,000	10% of the taxable income
Over \$6,000 but not over \$28,400	\$600 plus 15% of the excess over \$6,000
Over \$28,400 but not over \$68,800	\$3,960 plus 27% of the excess over \$28,400
Over \$68,800 but not over \$143,500	\$14,868 plus 30% of the excess over \$68,800
Over \$143,500 but not over \$311,950	\$37,278 plus 35% of the excess over \$143,500
Over \$311,950	\$96,235.50 plus 38.6% of the excess over \$311,950

SCHEDULE X: FILING STATUS—SINGLE: Tax Year 2003 After the 2003 Act	
<u>Taxable Income</u>	<u>Tax</u>
Not over \$7,000	10% of the taxable income
Over \$7,000 but not over \$28,400	\$700 plus 15% of the amount over \$7,000
Over \$28,400 but not over \$68,800	\$3,910 plus 25% of the amount over \$28,400
Over \$68,800 but not over \$143,500	\$14,010 plus 28% of the amount over \$68,800
Over \$143,500 but not over \$311,950	\$34,926 plus 33% of the amount over \$143,500
Over \$311,950	\$90,514.50 plus 35% of the amount over \$311,950

Note that the \$1,000 expansion of the 10% bracket for single taxpayers is accompanied by a \$1,000 reduction in the 15% bracket. In addition, the 10 and 15% rates were not reduced, as were the four higher brackets. As a result, a single taxpayer with taxable income of \$28,400 will see a reduction of only \$50 in his or her tax bill. Contrast that with a single taxpayer with taxable income of \$143,500 who would have his or her tax liability reduced by \$2,352. The savings disparity is even more severe at the highest rate which had the largest rate reduction (3.6% compared to 2% and zero percent for the lower rates).

**SCHEDULE Y1: FILING STATUS—MARRIED,
FILING JOINT RETURN AND SURVIVING SPOUSE:
Tax Year 2003 Before the 2003 Act**

<u>Taxable Income</u>	<u>Tax</u>
Not over \$12,000	10% of the taxable income
Over \$12,000 but not over \$47,450	\$1,200 plus 15% of the excess over \$12,000
Over \$47,450 but not over \$114,650	\$6,517.50 plus 27% of the excess over \$47,450
Over \$114,650 but not over \$174,700	\$24,661.50 plus 30% of the excess over \$114,650
Over \$174,700 but not over \$311,950	\$42,676.50 plus 35% of the excess over \$174,700
Over \$311,950	\$90,714 plus 38.6% of excess over \$311,950

**SCHEDULE Y1: FILING STATUS—MARRIED,
FILING JOINT RETURN AND SURVIVING SPOUSE:
Tax Year 2003 After the 2003 Act**

<u>Taxable Income</u>	<u>Tax</u>
Not over \$14,000	10% of the taxable income
Over \$14,000 but not over \$56,800	\$1,400 plus 15% of the excess over \$14,000
Over \$56,800 but not over \$114,650	\$7,820 plus 25% of the excess over \$56,800
Over \$114,650 but not over \$174,700	\$22,282.50 plus 28% of the excess over \$114,650
Over \$174,700 but not over \$311,950	\$39,096.50 plus 33% of the excess over \$174,700
Over \$311,950	\$84,389 plus 35% of the excess over \$311,950

For married taxpayers, both the 10% and 15% brackets were expanded under the 2003 Act. The 10% bracket was expanded by \$2,000 for a maximum tax savings of \$100. The expansion of the 15% bracket to twice the 15% bracket for single taxpayers was intended to minimize the so called marriage penalty, but it came at the expense of a reduction in the span of the 25% bracket by \$9,350. The expansion of the 15% bracket by \$7,350 yields a maximum tax savings of \$1,102.50. The decision to keep the top taxable income in the 25% bracket at \$114,650 instead of allowing it to slide up to \$124,000 (\$114,650 + \$9,350) costs a married couple with taxable income of \$124,000, \$2337.50. The same computations can be made for the higher brackets as well.

SCHEDULE Y2:FILING STATUS—MARRIED, SEPARATE: Tax Year 2003 Before the 2003 Act	
<u>Taxable Income</u>	<u>Tax</u>
Not Over \$6,000	10% of the taxable income
Over \$6,000 but not over \$23,725	\$600 plus 15% of the excess over \$6,000
Over \$23,725 but not over \$57,325	\$3,258.75 plus 27% of the excess over \$23,725
Over \$57,325 but not over \$87,350	\$12,330.75 plus 30% of the excess over \$57,325
Over \$87,350 but not over \$155,975	\$21,338.25 plus 35% of the excess over \$87,350
Over \$155,975	\$45,357 plus 38.6% of the excess over \$155,975

SCHEDULE Y2:FILING STATUS—MARRIED, SEPARATE: Tax Year 2003 After the 2003 Act	
<u>Taxable Income</u>	<u>Tax</u>
Not Over \$7,000	10% of the taxable income
Over \$7,000 but not over \$28,400	\$700 plus 15% of the excess over \$7,000
Over \$28,400 but not over \$57,325	\$3,910 plus 25% of the excess over \$28,400
Over \$57,325 but not over \$87,350	\$11,141.25 plus 28% of the excess over \$57,325
Over \$87,350 but not over \$155,975	\$19,548.25 plus 33% of the excess over \$87,350
Over \$155,975	\$42,194.50 plus 35% of the excess over \$155,975

The married separate schedules are half the married filing jointly schedules.

SCHEDULE Z: FILING STATUS—HEAD OF HOUSEHOLD: Tax Year 2003 Before the 2003 Act	
<u>Taxable Income</u>	<u>Tax</u>
Not Over \$10,000	10% of the taxable income
Over \$10,000 but not over \$38,050	\$1,000 plus 15% of the excess over \$10,000
Over \$38,050 but not over \$98,250	\$5,207.50 plus 27% of the excess over \$38,050
Over \$98,250 but not over \$159,100	\$21,461.50 plus 30% of the excess over \$98,250
Over \$159,100 but not over \$311,950	\$39,716.50 plus 35% of the excess over \$159,100
Over \$311,950	\$93,214 plus 38.6% of the excess over \$311,950

SCHEDULE Z: FILING STATUS—HEAD OF HOUSEHOLD: Tax Year 2003 After the 2003 Act	
<u>Taxable Income</u>	<u>Tax</u>
Not Over \$10,000	10% of the taxable income
Over \$10,000 but not over \$38,050	\$1,000 plus 15% of the excess over \$10,000
Over \$38,050 but not over \$98,250	\$5,207.50 plus 25% of the excess over \$38,050
Over \$98,250 but not over \$159,100	\$20,257.50 plus 28% of the excess over \$98,250
Over \$159,100 but not over \$311,950	\$37,295.50 plus 33% of the excess over \$159,100
Over \$311,950	\$87,736 plus 35% of the excess over \$311,950

Note that low-income head-of-household filers (taxable incomes below \$38,050) were offered no reduction in tax under the new schedule. This is curious in that the taxpayers who qualify for head of household status are often those who need help the most. Surely if the purpose of the 2003 Act was to provide an economic stimulus, then it would have been very efficient to provide low-income head of household filers a tax reduction, because they would likely spend any tax savings that come their way. Again the bulk of the tax savings accrue to those in the highest tax brackets, for example, \$1,204 with taxable income of \$98,250, compared to the zero dollars of tax savings offered to head of household filers with taxable incomes below \$38,050 as discussed above.

Transitory Nature of the 10% Bracket Increases:

The expansion of the 10% bracket lasts only for 2003 and 2004. Beginning in 2005, the 10% bracket for singles and married filing separate falls back to \$6,000 and to \$12,000. The 10% brackets then rise to \$7,000 and \$14,000 for tax years 2008 and beyond.

Mitigation of the Marriage Penalty Provisions

Tax Brackets

As indicated above, the expansion of the 15% bracket for married joint filers to twice the 15% bracket for single filers is intended to mitigate the effects of the marriage penalty. Of course, just expanding the 15% bracket does not eliminate the marriage penalty. It is effective only for the taxable incomes between \$47,500 and \$56,800, and yields a maximum tax savings of only \$1,395.

The marriage penalty is still alive and well for high-income married taxpayers. For example, assume a married couple has taxable income of \$311,950. Under the post 2003 Act tax schedules, their tax liability would be \$84,389. Assuming both spouses produced one half of the taxable income (\$155,975 each), had they filed as single taxpayers their tax liability would be \$78,085.50 (\$39,042.75 each), a marriage penalty of \$6,303.50.

The expansion of the 15% bracket for married joint filers to twice the amount of the single taxpayer's 15% bracket is effective only for tax years 2003 and 2004. After 2004, the brackets revert back to the pre-2003 Act levels.

Standard Deduction

For the years 2003 and 2004, the standard deduction for married joint filers is set at twice the amount of the standard deduction for a single taxpayer. For 2003, the standard deduction for a married joint filer will be \$9,500 instead of \$7,850 (a difference of \$1,650) which would result in a tax savings of \$412.50 at a marginal tax rate of 25%. The standard deduction will revert to pre-2003 Act amounts after 2004.

Increasing the standard deduction, however, provides no relief for those married couples who have itemized deductions of at least \$9,500. For example, a taxpayer with an outstanding home mortgage of \$150,000 (even at a 5% interest rate) and property taxes of \$2,500 would receive no relief.

Increased Child Care Credit

The 2003 Act increased the child care credit from \$600 to \$1,000 per qualified child (dependant child under the age of 17) for tax years 2003 and 2004. In addition, taxpayers who claimed the credit in tax year 2002 will receive an advance payment of the increase based on the information in their 2002 return beginning in July 2003. For example, a married couple with one child who were eligible for the full credit in 2002 would receive an advance payment check of \$400 sometime after July 2003. The advance

payment is not an addition to the credit a taxpayer was eligible for in 2002, but rather a down payment from the Treasury Department on the amount of the credit the taxpayer is eligible for in 2003. For example, assume John and Mary have a 10-year-old daughter and they claimed the full \$600 child care credit in 2002. Based on that information the Internal Revenue Service will issue John and Mary a \$400 check sometime after July 2003. When John and Mary file their 2003 return, they will be eligible for only the original \$600 of child care credit.

The phase-out ranges were not changed. The credit is reduced by \$50 for every \$1,000 of AGI in excess of \$110,000 for married joint filers, \$75,000 for unmarried filers and \$55,000 for married separate filers. As a result some taxpayers whose credit would have been phased-out before the 2003 Act may now be eligible for a portion of the credit. For example, assume John and Mary have one eligible child in 2003 and their adjusted gross income is \$124,000. Before the 2003 Act, John and Mary would not have been able to claim the credit due to the phase-out rule. $\$600 - [\$124,000 - \$110,000 / \$1000 \times \$50] = \0 . After the 2003 Act, however, John and Mary will receive a credit of \$300. $\$1,000 - [\$124,000 - \$110,000 / \$1000 \times \$50] = \300 .

After 2004, the credit reverts back to its pre-2003 Act increase schedule. The credit will be \$700 for tax years 2005 to 2008, \$800 for tax year 2009 and finally back to \$1,000 in 2010.

Although the Senate version of the 2003 Act made the child care credit refundable, that provision was stripped out of the final version by House members of the conference committee. This means that taxpayers with modest incomes (under \$25,000) with qualifying children will not benefit from the increased credit since their tax liability is less than the credit. Immediately after the 2003 Act was signed into law, the Senate passed an amendment making the credit refundable. House Republicans opposed the measure but eventually passed an amendment like the Senate's, but also added significant business tax benefits the Senate was unlikely to accept. As of this writing, the matter was still unsettled.

Preferable Rates for Dividend Income and Capital Gains

Dividend Income

The cornerstone of Presidents Bush's Tax Cut Proposal of 2003 was to exclude dividend income from taxation. He argued that if dividends were not taxable, more people would invest in corporations, resulting in more business capital which would spur business expansion and ultimately job growth. The proposal ran into stiff opposition in the Senate when enough moderate Republican Senators refused to sign on. The compromise that eventually became law under the 2003 Act taxes qualified dividend income as net long term capital gain. (See discussion of tax rates for net long term capital gains below). This is a major departure for the tax system. Traditionally, there have only been two classes or flavors of income: ordinary income and capital gain income. Long term capital gains have traditionally been afforded preferential rates due to the length of time it took to produce the gain. Because tax years are arbitrary filing periods (for example, we could file returns every three months or every five years instead of annually) the entire gain is taxed in one period instead of incrementally over the several periods the

gain occurred. There is not similar reasoning behind creating a new class of income for dividends. In fact, most corporations pay dividends quarterly. Hence there is not a problem with income bunching, as is the case with long-term capital gains. Since corporations pay a separate federal income tax before dividends are paid to shareholders, the argument in favor of creating a new class of income for qualified dividend income is that taxing dividends to shareholders is the second time that income is taxed; first at the corporate level and second at the individual level.

The provision has been criticized as a boon to the wealthy, since only the wealthy have enough stock holdings to generate sufficient dividends to produce significant tax savings. Supporters of the provision point out that a majority of Americans hold stocks, so the reduced rate on dividends will benefit most Americans. It is true that a majority of Americans hold stock, but a substantial amount of those stock holdings are in tax deferred retirement savings plans. Since no tax is paid on dividends in such plans, there is no benefit. Even those Americans with moderate stock portfolios of up to \$50,000, probably receive annual dividend income of at most \$2,500, producing a tax savings of \$250.

Qualified dividend income is dividend income from domestic corporations (U.S. Corporations) and from qualified foreign corporations. A qualified foreign corporation is one that is incorporated in a U.S. possession or is incorporated in a country that is a party to a tax treaty with the U.S. that the IRS determines is sufficiently comprehensive. In other words, corporations incorporated in most of the U.S. trading partners.

Net Long Term Capital Gains

The 2003 Act reduced the tax rates on net long term capital gains from 20% and 10% to 15% and 5%. The old 10% rate and the new 5% rate apply to taxpayers in the 10 and 15 percent tax brackets on ordinary income. The amount of the capital gain preference has increased significantly for high-income taxpayers. For example, the preference for taxpayers in the old 38.6 bracket was 18.6% (38.6 – 20). The preference for the same taxpayer is now 20% (35 – 15). The preference is not as large for lower income taxpayers. For example, the preference for a taxpayers in the 25% and 15% tax brackets is only 10% (25 – 15 and 15 – 5). The lowest income taxpayers (those in the 10% tax bracket) have only a 5% capital gain preference (10 – 5).

Provisions Applicable to Dividend Income and Net Long Term Capital Gains

The treatment of dividend income as net long term capital gain and the reduced tax rates on net long term capital gains expire for tax years beginning after 2008. As a result, without further congressional action, dividend income will return to its ordinary income status and the rates on net long term capital gains will revert back to the pre-2003 Act rates. In an oddity, the 5% rate for net long term capital gains (and qualified dividend income) drops to zero for tax years beginning after 2007. As a result, taxpayers in the 10 and 15% tax brackets with qualified dividend income or net long term capital gains will take that income tax free. It only works for 2008, however, since all of the 2003 Act provision applicable to qualified dividend income and net long term capital gains expire for tax years beginning after 2008.

Endnote

¹ Unless otherwise indicated, the source material for this supplement is Research Institute of America—Checkpoint’s *Complete Analysis of the Jobs and Growth Tax Relief Reconciliation Act of 2003*, (May 2003).