Tax Law Implications Story: Tax Savings You Can Bank On

By Susan Roberts, CPA

Abstract

Susan S. Roberts, CPA, of Sanford, Baumeister & Frazier, PC, discusses specific tax saving opportunities provided in the changes enacted in the 2003 Tax Act that have positive repercussions for work, home, and the future. Her article takes a quick look at the law's impact in selected areas for three groups:

- Small business owners
- The American family
- Investors

A Plus for Small Businesses

Goodbye, Depreciation; Hello, Expense! (Plus a Bonus or Two to Drive to the Bank)

To look at the impact of the tax environment changes for 2003 and 2004, Sanford, Baumeister & Frazier, PC's Susan S. Roberts, CPA, recently selected 10 privately held businesses from SBF's client group in order to illustrate some beneficial aspects of the new law for businesses. All 10 had placed capital assets in service in year 2000. She compared the deduction possibilities on the fixed assets placed in service before September 11, 2001 to the deductions possible if these same assets were placed in service after May 5, 2003, when the new tax law changes took effect.

Those changes work like this. In the 2003 Tax Act, Section 179 allows a small business to expense a qualified asset that would otherwise have to be capitalized and depreciated over its useful life. It's called an expensing allowance. This provision could greatly decrease the 2003 – 2005 tax burden for small businesses. Available for years 2003, 2004, and 2005, the expensing allowance (Sec. 179) has increased from $25,000 to $100,000 for businesses that place in service less than $400,000 of qualifying equipment in a year. Also, the 2003 Tax Act increased bonus depreciation on qualified assets from 30 percent to 50 percent, for assets placed in service after May 5, 2003 and before 2005. Historically, these qualified assets had to be capitalized and depreciated over their useful life. Now, taxpayers can write off half of the cost in the year of purchase. Even some leasehold improvements will qualify for this 50 percent write-off.

In comparing how the fixed asset depreciation change could impact the representative businesses, Ms. Roberts looked at their depreciation schedules and prepared a detailed depreciation analysis. The analysis compared the deduction these companies could have taken on fixed assets placed in service before September 11, 2001 to the deduction they could have taken if these same assets were placed in service after May 5, 2003.

Her sample used criteria such as general industry and size of the client and the value of assets placed in service in that foundation year.

Results indicate that the law can result in quite a savings. As a group, her representative companies placed in service $2,744,376 of fixed assets in total (an average of $274,438 per company). She calculated the tax that would be saved if the same value of assets were placed in service in 2003.

- In 2001, the maximum depreciation deduction for survey group would have been $515,595, which is just under 19 percent of the total asset cost.

- If the same $2.744 million of fixed assets were placed in service in the last half of 2003, the maximum depreciation deduction would jump to $1,879,619, which is just over 68 percent of the total asset cost.

The additional write-off? A total of $1,364,024, or an average of $136,402 per company.

The tax law change extends to vehicles for businesses, too. Small business owners who use automobiles in their business have received some tax breaks for 2003 and future years.

Under the new Temporary Regulations, “qualified nonpersonal use vehicles” will not be subject to the luxury automobile limits, as they have been in the past. For example, currently luxury automobiles are capped as to the maximum amount of depreciation that may be taken in any year. This luxury automobiles category used to include “qualified nonpersonal use vehicles.”

Now, these qualified nonpersonal vehicles are allowed the full depreciation write-off, including Section 179 and bonus depreciation write-offs, in the year of purchase. To translate, qualified nonpersonal use vehicles include those that have been specifically modified for business use---like hearses, ambulances, plumbing trucks, glass trucks, and so forth. If the vehicle has permanent advertising, toolboxes added or seats removed, it may qualify. Check with your accountant.

A Boost for the American Family

Ms. Roberts also looked at tax liability changes as they affect people at home. A decrease in tax liability is evident, resulting from lower individual income tax rates. All income tax brackets above 15 percent received a rate reduction. The highest rate has been decreased from the scheduled 38.6 percent to 35 percent through 2010.

The 2003 tax act increased the size of the 15 percent tax bracket for taxpayers that are married filing jointly. This increase causes more dollars to be taxed at the 15 percent rate as opposed to higher income tax rates. The bigger bracket will save joint filers a minimum of $935 in tax if their taxable income is over $56,800 in 2003.

For married couples who file a joint return, the standard deduction has been increased from $7,850 in 2002, to $9,500 for 2003. This helps for every level: taxpayers in the lowest tax bracket pay at least $165 less in tax for 2003.

There’s also a decrease in tax liability resulting from an increased Child Tax Credit for 2003 and 2004 only. The credit increased from the scheduled $600 to $1,000 per child under 17. The credit begins to phase out at $110,000 for joint filers and at $55,000 for single filers.

Finally, the tax law changes help put out-of-pocket money back in your pocket. Flexible Spending Accounts and Section 125 plans that reimburse individuals for medical costs can now reimburse for non-prescription medications, including antacids, cold medicines, pain pills, etc. Therefore, participants in these plans may wish to increase their pre-tax contributions.

A Leg Up for Individual Investors

The 2003 Tax Act reduced the capital gains rate from 20 percent to 15 percent for taxpayers in the higher income tax brackets. In addition, it reduced the capital gains rate from 10 percent to 5 percent for taxpayers in the lower 10 percent or 15 percent income tax brackets. This change in the tax law will encourage investors to sell long term investments, due to the decreased tax bite.

The 2003 Tax Act has reduced the tax rate on qualified dividends paid to individuals to the capital gains rates. Therefore, dividends will be taxed at a maximum rate of 15 percent. Such a change may encourage investors

to take another look at the stock market, since the tax hit on dividends will be less than the tax hit on interest income. Interest income is taxed at ordinary rates, which can go as high as 35 percent.

Another warm thought for this winter: investors can now sock away additional funds into retirement plans. For 2004, taxpayers under age 50 can put up to $13,000 into a 401(k), while taxpayers who are 50 or over can defer as much as $16,000, playing a bit of catch up. If your employer is a smaller business, SIMPLE plan participants under age 50 can invest up to $9,000 in 2004, while individuals ages 50 and up can contribute up to $10,500 into a SIMPLE in 2004.

Any way you look at it, the tax bite has turned into a nibble with the implications of this new tax law, at least at work, at home, and for investors for the near term. Nearly makes us look forward to April 15, doesn't it?

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