

NEW TAX ACT AIDS SMALL BUSINESSES

While attention has focused mostly on individual taxpayers and investors, the new Jobs and Growth Tax Relief Reconciliation Act of 2003 provides several direct and indirect benefits for the small-business owner.

Tax rate cuts. Perhaps the most obvious benefit to the small-business owner is the acceleration of the reduction of personal tax rates scheduled under the 2001 tax act. This will not only reduce the tax bite of the owner's personal income—the top rate drops immediately from 38.6 percent to 35 percent—but, in theory, it will stimulate the recovery of the economy, thus boosting small business.

The reduction in the capital gains tax (the maximum regular rate goes from 20 percent to 15 percent), and the reduction of the dividend tax (for C corporations only) to the same rate as the applicable capital gains rate, should also make it more attractive to invest in small businesses. But the 2003 tax act also offers several provisions designed specifically for small business.

Boosting expensing amount. The new act quadruples the amount of qualified property a small business can expense in a single tax year under Internal Revenue Code Section 179—from \$25,000 to \$100,000. The act also raised the phaseout amount beyond which the allowed expensing is reduced, from \$200,000 to \$400,000. (For example, if you buy \$430,000 in equipment, you can only expense \$70,000 instead of \$100,000.) These amounts will be indexed for inflation for years 2004 and 2005. After 2005, however, the new provisions expire and everything reverts to the old numbers.

Business property that qualifies for expensing is depreciable tangible personal property, used or new. The 2003 act adds to this list off-the-shelf software, which did not qualify in the past.

Faster bonus depreciation. For new property that you don't want to expense or can't, the new act raises the upfront bonus depreciation (created in a 2002 tax act) from 30 percent to 50 percent. It also upped a similar bonus depreciation on certain business vehicles.

To qualify, the property must be acquired and placed into service after May 5, 2003, and no later than December 31, 2004. Property under a binding contract for purchase before May 6, 2003, will not qualify for the 50 percent bonus, but it would qualify for the 30 percent bonus for property bought after September 10, 2001.

The bonus depreciation applies on top of the regular depreciation you can take, and you can still expense some of the property under Section 179. But you must elect out of this mandatory first-year bonus should you decide you're financially better off declining the bonus and spreading out your depreciation.

Reduction of small-business stock as a tax preference. Noncorporate investors who buy stock from a small business that has assets of not more than \$50 million, and who hold that stock for at least five years, generally have been able to exclude up to 50 percent of any capital gains. But for some investors, the alternative minimum tax ate away some of the savings. The new act significantly reduces the potential exposure of the gains to AMT, and thus investors may be more willing to buy qualified small-business stock.

Reduced accumulated earnings tax and reduced personal holding company tax.

The new act reduces the accumulated earnings tax for corporations from the highest current tax rate for individuals (35 percent under the new act) to 15 percent. Earnings subject to this tax are generally earnings retained by a corporation beyond what is considered "reasonable" for business purposes, instead of being paid out as dividends to shareholders.

The act also reduces to 15 percent the tax on retained earnings that aren't distributed to shareholders of a personal holding company.

Change corporate entity? Experts are still analyzing the impact of the new tax on what entity type might be most beneficial to small businesses under the new law, but the initial feeling is that C corporations might become more attractive than they were before compared with the popular S corporation. Small-business owners will want to monitor this area closely in the coming months and talk with their financial advisors and attorney.

Estimated tax postponed. The corporate estimated tax payment that would have been due this September 15 has been postponed to October 1.