

**DESCRIPTION OF THE CHAIRMAN'S AMENDMENT
IN THE NATURE OF A SUBSTITUTE
TO H.R. 2, THE
"JOBS AND GROWTH TAX ACT OF 2003"**

Scheduled for Markup
By the
HOUSE COMMITTEE ON WAYS AND MEANS
on May 6, 2003

Prepared by the Staff
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INTRODUCTION

This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's amendment in the nature of a substitute to H.R. 2, the "Jobs and Growth Tax Act of 2003." The House Committee on Ways and Means has scheduled a markup of the bill for May 6, 2003.

¹ This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Amendment in the Nature of Substitute to H.R. 2, the "Jobs and Growth Tax Act of 2003"* (JCX-40-03), May 5, 2003.

I. ACCELERATION OF CERTAIN PREVIOUSLY ENACTED TAX REDUCTIONS

A. Accelerate the Increase in the Child Tax Credit

Present Law

In general

For 2003, an individual may claim a \$600 tax credit for each qualifying child under the age of 17. In general, a qualifying child is an individual for whom the taxpayer can claim a dependency exemption and who is the taxpayer's son or daughter (or descendent of either), stepson or stepdaughter (or descendent of either), or eligible foster child.

The child tax credit is scheduled to increase to \$1,000, phased in over several years.

Table 1, below, shows the scheduled increases of the child tax credit as provided under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA").

Table 1.—Scheduled Increase of the Child Tax Credit

Taxable Year	Credit Amount Per Child
2003-2004	\$600
2005-2008	\$700
2009	\$800
2010 and later ¹	\$1,000

¹ The credit reverts to \$500 in taxable years beginning after December 31, 2010, under the sunset provision of EGTRRA.

The child tax credit is phased out for individuals with income over certain thresholds. Specifically, the otherwise allowable child tax credit is reduced by \$50 for each \$1,000 (or fraction thereof) of modified adjusted gross income over \$75,000 for single individuals or heads of households, \$110,000 for married individuals filing joint returns, and \$55,000 for married individuals filing separate returns.² The length of the phase-out range depends on the number of qualifying children. For example, the phase-out range for a single individual with one qualifying child is between \$75,000 and \$85,000 of modified adjusted gross income. The phase-out range for a single individual with two qualifying children is between \$75,000 and \$95,000.

The amount of the tax credit and the phase-out ranges are not adjusted annually for inflation.

² Modified adjusted gross income is the taxpayer's total gross income plus certain amounts excluded from gross income (i.e., excluded income of U.S. citizens or residents living abroad (sec. 911); residents of Guam, American Samoa, and the Northern Mariana Islands (sec. 931); and residents of Puerto Rico (sec. 933)).

Refundability

For 2003, the child credit is refundable to the extent of 10 percent of the taxpayer's earned income in excess of \$10,500.³ The percentage is increased to 15 percent for taxable years beginning in 2005 and thereafter. Families with three or more children are allowed a refundable credit for the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit, if that amount is greater than the refundable credit based on the taxpayer's earned income in excess of \$10,500 (for 2003). The refundable portion of the child credit does not constitute income and is not treated as resources for purposes of determining eligibility or the amount or nature of benefits or assistance under any Federal program or any State or local program financed with Federal funds. For taxable years beginning after December 31, 2010, the sunset provision of EGTRRA applies to the rules allowing refundable child credits.

Alternative minimum tax liability

The child credit is allowed against the individual's regular income tax and alternative minimum tax. For taxable years beginning after December 31, 2010, the sunset provision of EGTRRA applies to the rules allowing the child credit against alternative minimum tax.

Description of Proposal

The amount of the child credit is increased to \$1,000 for 2003 through 2005. After 2005 the child credit will revert to the levels provided under present law. For 2003, the increased amount of the child credit will be paid in advance beginning in July 2003 on the basis of information on each taxpayer's 2002 return filed in 2003. Such payments will be made in a manner similar to the advance payment checks issued by the Treasury in 2001 to reflect the creation of the 10-percent regular income tax rate bracket.⁴

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002, and before January 1, 2006.

³ The \$10,500 amount is indexed for inflation.

⁴ The increase in refundability to 15 percent of the taxpayer's earned income, scheduled for calendar years 2005 and thereafter, is not accelerated by the proposal.

B. Accelerate Marriage Penalty Relief

1. Standard deduction marriage penalty relief

Present Law

Marriage penalty

A married couple generally is treated as one tax unit that must pay tax on the couple's total taxable income. Although married couples may elect to file separate returns, the rate schedules and other provisions are structured so that filing separate returns usually results in a higher tax than filing a joint return. Other rate schedules apply to single persons and to single heads of households.

A "marriage penalty" exists when the combined tax liability of a married couple filing a joint return is greater than the sum of the tax liabilities of each individual computed as if they were not married. A "marriage bonus" exists when the combined tax liability of a married couple filing a joint return is less than the sum of the tax liabilities of each individual computed as if they were not married.

Basic standard deduction

Taxpayers who do not itemize deductions may choose the basic standard deduction (and additional standard deductions, if applicable),⁵ which is subtracted from adjusted gross income ("AGI") in arriving at taxable income. The size of the basic standard deduction varies according to filing status and is adjusted annually for inflation.⁶ For 2003, the basic standard deduction for married couples filing a joint return is 167 percent of the basic standard deduction for single filers. (Alternatively, the basic standard deduction amount for single filers is 60 percent of the basic standard deduction amount for married couples filing joint returns.) Thus, two unmarried individuals have standard deductions whose sum exceeds the standard deduction for a married couple filing a joint return.

EGTRRA increased the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return.⁷ The increase in the standard deduction for married taxpayers filing a joint return is scheduled to be

⁵ Additional standard deductions are allowed with respect to any individual who is elderly (age 65 or over) or blind.

⁶ For 2003 the basic standard deduction amounts are: (1) \$4,750 for unmarried individuals; (2) \$7,950 for married individuals filing a joint return; (3) \$7,000 for heads of households; and (4) \$3,975 for married individuals filing separately.

⁷ The basic standard deduction for a married taxpayer filing separately will continue to equal one-half of the basic standard deduction for a married couple filing jointly; thus, the basic standard deduction for unmarried individuals filing a single return and for married couples filing separately will be the same after the phase-in period.

phased-in over five years beginning in 2005 and will be fully phased-in for 2009 and thereafter. Table 2, below, shows the standard deduction for married couples filing a joint return as a percentage of the standard deduction for single individuals during the phase-in period.

Table 2.—Scheduled Phase-In of Increase of the Basic Standard Deduction for Married Couples Filing Joint Returns

Taxable Year	Standard Deduction for Married Couples Filing Joint Returns as Percentage of Standard Deduction for Unmarried Individual Returns
2005	174
2006	184
2007	187
2008	190
2009 and later ¹	200

¹ The basic standard deduction increases are repealed for taxable years beginning after December 31, 2010, under the sunset provision of EGTRRA.

Description of Proposal

The proposal accelerates the increase in the basic standard deduction amount for joint returns to twice the basic standard deduction amount for single returns effective for 2003, 2004, and 2005. For taxable years beginning after 2005, the applicable percentages would revert to those allowed under present law, as described above.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002, and before January 1, 2006.

2. Accelerate the expansion of the 15-percent rate bracket for married couples filing joint returns

Present Law

In general

Under the Federal individual income tax system, an individual who is a citizen or resident of the United States generally is subject to tax on worldwide taxable income. Taxable income is total gross income less certain exclusions, exemptions, and deductions. An individual may claim either a standard deduction or itemized deductions.

An individual's income tax liability is determined by computing his or her regular income tax liability and, if applicable, alternative minimum tax liability.

Regular income tax liability

Regular income tax liability is determined by applying the regular income tax rate schedules (or tax tables) to the individual's taxable income and then is reduced by any applicable tax credits. The regular income tax rate schedules are divided into several ranges of income, known as income brackets, and the marginal tax rate increases as the individual's income increases. The income bracket amounts are adjusted annually for inflation. Separate rate schedules apply based on filing status: single individuals (other than heads of households and surviving spouses), heads of households, married individuals filing joint returns (including surviving spouses), married individuals filing separate returns, and estates and trusts. Lower rates may apply to capital gains.

In general, the bracket breakpoints for single individuals are approximately 60 percent of the rate bracket breakpoints for married couples filing joint returns.⁸ The rate bracket breakpoints for married individuals filing separate returns are exactly one-half of the rate brackets for married individuals filing joint returns. A separate, compressed rate schedule applies to estates and trusts.

15-percent regular income tax rate bracket

EGTRRA increased the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return to twice the size of the corresponding rate bracket for a single individual filing a single return. The increase is phased-in over four years, beginning in 2005. Therefore, this provision is fully effective (i.e., the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return is twice the size of the 15-percent regular income tax rate bracket for an unmarried individual filing a single return) for taxable years beginning after December 31, 2007. Table 3, below, shows the increase in the size of the 15-percent bracket during the phase-in period.

⁸ Under present law, the rate bracket breakpoint for the 38.6 percent marginal tax rate is the same for single individuals and married couples filing joint returns. Present-law rate changes do not alter this breakpoint.

**Table 3.—Scheduled Increase in Size of the 15-Percent Rate Bracket
for Married Couples Filing Joint Returns**

Taxable year	End Point of 15-Percent Rate Bracket for Married Couples Filing Joint Returns as Percentage of End Point of 15-Percent Rate Bracket for Unmarried Individuals
2005	180
2006	187
2007	193
2008 and thereafter ¹	200

¹ The increases in the 15-percent rate bracket for married couples filing a joint return are repealed for taxable years beginning after December 31, 2010, under the sunset of EGTRRA.

Description of Proposal

The proposal accelerates the increase of the size of the 15-percent regular income tax rate bracket for joint returns to twice the width of the 15-percent regular income tax rate bracket for single returns for taxable years beginning in 2003, 2004, and 2005. For taxable years beginning after 2005, the applicable percentages would revert to those allowed under present law, as described above.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002, and before January 1, 2006.

C. Accelerate Reductions in Individual Income Tax Rates

Present Law

In general

Under the Federal individual income tax system, an individual who is a citizen or a resident of the United States generally is subject to tax on worldwide taxable income. Taxable income is total gross income less certain exclusions, exemptions, and deductions. An individual may claim either a standard deduction or itemized deductions.

An individual's income tax liability is determined by computing his or her regular income tax liability and, if applicable, alternative minimum tax liability.

Regular income tax liability

Regular income tax liability is determined by applying the regular income tax rate schedules (or tax tables) to the individual's taxable income. This tax liability is then reduced by any applicable tax credits. The regular income tax rate schedules are divided into several ranges of income, known as income brackets, and the marginal tax rate increases as the individual's income increases. The income bracket amounts are adjusted annually for inflation. Separate rate schedules apply based on filing status: single individuals (other than heads of households and surviving spouses), heads of households, married individuals filing joint returns (including surviving spouses), married individuals filing separate returns, and estates and trusts. Lower rates may apply to capital gains.

For 2003, the regular income tax rate schedules for individuals are shown in Table 4, below. The rate bracket breakpoints for married individuals filing separate returns are exactly one-half of the rate brackets for married individuals filing joint returns. A separate, compressed rate schedule applies to estates and trusts.

Table 4.—Individual Regular Income Tax Rates for 2003

If taxable income is over:	But not over:	Then regular income tax equals:
<i>Single Individuals</i>		
\$0.....	\$6,000	10% of taxable income
\$6,000.....	\$28,400	\$600, plus 15% of the amount over \$6,000
\$28,400.....	\$68,800	\$3,960, plus 27% of the amount over \$28,400
\$68,800.....	\$143,500	\$14,868, plus 30% of the amount over \$68,800
\$143,500.....	\$311,950	\$37,278, plus 35% of the amount over \$143,500
Over \$311,950.....		\$96,235.50, plus 38.6% of the amount over \$311,950

Head of Households

\$0.....	\$10,000	10% of taxable income
\$10,000.....	\$38,050	\$1,000, plus 15% of the amount over \$10,000
\$38,050.....	\$98,250	\$5,207.50, plus 27% of the amount over \$38,050
\$98,250.....	\$159,100	\$21,461.50, plus 30% of the amount over \$98,250
\$159,100.....	\$311,950	\$39,716.50, plus 35% of the amount over \$159,100
Over 311,950		\$93,214, plus 38.6% of the amount over \$311,950

Married Individuals Filing Joint Returns

\$0.....	\$12,000	10% of taxable income
\$12,000.....	\$47,450	\$1,200, plus 15% of the amount over \$12,000
\$47,450.....	\$114,650	\$6,517.50, plus 27% of the amount over \$47,450
\$114,650.....	\$174,700	\$24,661.50, plus 30% of the amount over \$114,650
\$174,700.....	\$311,950	\$42,676.50, plus 35% of the amount over \$174,700
Over 311,950		\$90,714, plus 38.6% of the amount over \$311,950

Ten-percent regular income tax rate

Under present law, the 10-percent rate applies to the first \$6,000 of taxable income for single individuals, \$10,000 of taxable income for heads of households, and \$12,000 for married couples filing joint returns. Effective beginning in 2008, the \$6,000 amount will increase to \$7,000 and the \$12,000 amount will increase to \$14,000.

The taxable income levels for the 10-percent rate bracket will be adjusted annually for inflation for taxable years beginning after December 31, 2008. The bracket for single individuals and married individuals filing separately is one-half for joint returns (after adjustment of that bracket for inflation).

The 10-percent rate bracket will expire for taxable years beginning after December 31, 2010, the sunset provision of EGTRRA.

Reduction of other regular income tax rates

Prior to EGTRRA the regular income tax rates were 15 percent, 28 percent, 31 percent, 36 percent, and 39.6 percent.⁹ EGTRRA added the 10-percent regular income tax rate, described above, and retained the 15-percent regular income tax rate. Also, the 15-percent regular income tax bracket was modified to begin at the end of the 10-percent regular income tax bracket. EGTRRA also made other changes to the 15-percent regular income tax bracket.¹⁰

Also, under EGTRRA, the 28 percent, 31 percent, 36 percent, and 39.6 percent rates are phased down over six years to 25 percent, 28 percent, 33 percent, and 35 percent, effective after June 30, 2001. The taxable income levels for the rates above the 15-percent rate in all taxable years are the same as the taxable income levels that apply under the prior-law rates.

Table 5, below, shows the schedule of regular income tax rate reductions.

Table 5.—Scheduled Regular Income Tax Rate Reductions

Calendar Year	28% rate reduced to:	31% rate reduced to:	36% rate reduced to:	39.6% rate reduced to:
2001 ¹ -2003	27%	30%	35%	38.6%
2004-2005	26%	29%	34%	37.6%
2006 and later ²	25%	28%	33%	35.0%

¹ Effective July 1, 2001.

² The reductions in the regular income tax rates are repealed for taxable years beginning after December 31, 2010, under the sunset of EGTRRA.

Alternative minimum tax

The alternative minimum tax is the amount by which the tentative minimum tax exceeds the regular income tax. An individual's tentative minimum tax is an amount equal to (1) 26 percent of the first \$175,000 (\$87,500 in the case of a married individual filing a separate return) of alternative minimum taxable income ("AMTI") in excess of a phased-out exemption amount and (2) 28 percent of the remaining AMTI. The maximum tax rates on net capital gain used in computing the tentative minimum tax are the same as under the regular tax. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments. The exemption amounts are: (1) \$49,000 (\$45,000 in taxable years beginning after 2004) in the case of married individuals filing joint returns and surviving spouses; (2) \$35,750 (\$33,750 in taxable years beginning after 2004) in the case of other unmarried individuals; (3) \$24,500

⁹ The regular income tax rates will revert to these percentages for taxable years beginning after December 31, 2010 under the sunset of EGTRRA.

¹⁰ See the discussion of the provision regarding marriage penalty relief in the 15-percent regular income tax bracket, above.

(\$22,500 in taxable years beginning after 2004) in the case of married individuals filing a separate return; and (4) \$22,500 in the case of an estate or trust. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) \$150,000 in the case of married individuals filing joint returns and surviving spouses, (2) \$112,500 in the case of other unmarried individuals, and (3) \$75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

Description of Proposal

10-percent regular income tax rate

The proposal accelerates the increase in the taxable income levels for the 10-percent rate bracket now scheduled for 2008 to be effective in 2003, 2004, and 2005. For taxable years beginning after December 31, 2005, the taxable income levels for the 10-percent rate bracket will revert to the levels allowed under present law. Specifically, for 2003, 2004, and 2005, the proposal increases the taxable income level for the 10-percent regular income tax rate brackets for single individuals from \$6,000 to \$7,000 and for married individuals filing jointly from \$12,000 to \$14,000. The taxable income levels for the 10-percent regular income tax rate bracket will be adjusted annually for inflation for taxable years beginning after December 31, 2003.

Reduction of other regular income tax rates

The proposal accelerates the reductions in the regular income tax rates in excess of the 15-percent regular income tax rate that are scheduled for 2004 and 2006. Therefore, for 2003 and thereafter, the regular income tax rates in excess of 15 percent under the proposal are 25 percent, 28 percent, 33 percent, and 35 percent.

Alternative minimum tax exemption amounts

The proposal increases the AMT exemption amount for married taxpayers filing joint returns and surviving spouses to \$64,000, and for unmarried taxpayers to \$43,250, for taxable years beginning in 2003, 2004, and 2005.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002 and before January 1, 2006.

II. DEPRECIATION AND EXPENSING PROVISIONS

A. Special Depreciation Allowance for Certain Property

Present Law

In general

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system (“MACRS”). Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from 3 to 25 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

Section 280F limits the annual depreciation deductions with respect to passenger automobiles to specified dollar amounts, indexed for inflation.

Section 167(f)(1) provides that capitalized computer software costs, other than computer software to which section 197 applies, are recovered ratably over 36 months.

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment generally may elect to deduct up to \$25,000 of the cost of qualifying property placed in service for the taxable year (sec. 179). In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business.

Additional first year depreciation deduction

The Job Creation and Worker Assistance Act of 2002¹¹ (“JCWAA”) allows an additional first-year depreciation deduction equal to 30 percent of the adjusted basis of qualified property.¹² The amount of the additional first-year depreciation deduction is not affected by a short taxable year. The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service.¹³ The basis of the property and the depreciation allowances in the year of purchase and

¹¹ Pub. Law No. 107-147, sec. 101 (2002).

¹² The additional first-year depreciation deduction is subject to the general rules regarding whether an item is deductible under section 162 or subject to capitalization under section 263 or section 263A.

¹³ However, the additional first-year depreciation deduction is not allowed for purposes of computing earnings and profits.

later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, there are no adjustments to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies. A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year.

In order for property to qualify for the additional first-year depreciation deduction it must meet all of the following requirements. First, the property must be property (1) to which MACRS applies with an applicable recovery period of 20 years or less, (2) water utility property (as defined in section 168(e)(5)), (3) computer software other than computer software covered by section 197, or (4) qualified leasehold improvement property (as defined in section 168(k)(3)).¹⁴ Second, the original use¹⁵ of the property must commence with the taxpayer on or after September 11, 2001.¹⁶ Third, the taxpayer must purchase the property within the applicable time period. Finally, the property must be placed in service before January 1, 2005. An extension of the placed in service date of one year (i.e., January 1, 2006) is provided for certain property with a recovery period of ten years or longer and certain transportation property.¹⁷ Transportation property is defined as tangible personal property used in the trade or business of transporting persons or property.

¹⁴ A special rule precludes the additional first-year depreciation deduction for any property that is required to be depreciated under the alternative depreciation system of MACRS.

¹⁵ The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer.

If in the normal course of its business a taxpayer sells fractional interests in property to unrelated third parties, then the original use of such property begins with the first user of each fractional interest (i.e., each fractional owner is considered the original user of its proportionate share of the property).

¹⁶ A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback.

If property is originally placed in service by a lessor (including by operation of section 168(k)(2)(D)(i)), such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale. A technical correction may be needed so the statute reflects this intent.

¹⁷ In order for property to qualify for the extended placed in service date, the property is required to have a production period exceeding two years or an estimated production period exceeding one year and a cost exceeding \$1 million.

The applicable time period for acquired property is (1) after September 10, 2001 and before September 11, 2004, but only if no binding written contract for the acquisition is in effect before September 11, 2001, or (2) pursuant to a binding written contract which was entered into after September 10, 2001, and before September 11, 2004.¹⁸ With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property after September 10, 2001, and before September 11, 2004. Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer. For property eligible for the extended placed in service date, a special rule limits the amount of costs eligible for the additional first year depreciation. With respect to such property, only the portion of the basis that is properly attributable to the costs incurred before September 11, 2004 (“progress expenditures”) is eligible for the additional first-year depreciation.¹⁹

Property does not qualify for the additional first-year depreciation deduction when the user of such property (or a related party) would not have been eligible for the additional first-year depreciation deduction if the user (or a related party) were treated as the owner.²⁰ For example, if a taxpayer sells to a related party property that was under construction prior to September 11, 2001, the property does not qualify for the additional first-year depreciation deduction. Similarly, if a taxpayer sells to a related party property that was subject to a binding written contract prior to September 11, 2001, the property does not qualify for the additional first-year depreciation deduction. As a further example, if a taxpayer (the lessee) sells property in a sale-leaseback arrangement, and the property otherwise would not have qualified for the additional first-year depreciation deduction if it were owned by the taxpayer-lessee, then the lessor is not entitled to the additional first-year depreciation deduction.

The limitation on the amount of depreciation deductions allowed with respect to certain passenger automobiles (sec. 280F) is increased in the first year by \$4,600 for automobiles that qualify (and do not elect out of the increased first year deduction). The \$4,600 increase is not indexed for inflation.

¹⁸ Property does not fail to qualify for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to September 11, 2001.

¹⁹ For purposes of determining the amount of eligible progress expenditures, it is intended that rules similar to sec. 46(d)(3) as in effect prior to the Tax Reform Act of 1986 shall apply.

²⁰ A technical correction may be needed so that the statute reflects this intent.

Description of Proposal

The proposal provides an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified property.²¹ Qualified property is defined in the same manner as for purposes of the 30-percent additional first-year depreciation deduction provided by the JCWAA except that the applicable time period for acquisition (or self construction) of the property is modified. In addition, property must be placed in service before January 1, 2006, to qualify.²² Property eligible for the 50-percent additional first year depreciation deduction is not eligible for the 30-percent additional first year depreciation deduction.

Under the proposal, in order to qualify the property must be acquired after May 5, 2003, and before January 1, 2006, and no binding written contract for the acquisition is in effect before May 6, 2003.²³ With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property after May 5, 2003. For property eligible for the extended placed in service date (i.e., certain property with a recovery period of ten years or longer and certain transportation property), a special rule limits the amount of costs eligible for the additional first year depreciation. With respect to such property, only progress expenditures properly attributable to the costs incurred before January 1, 2006, shall be eligible for the additional first year depreciation.²⁴

The proposal also increases the limitation on the amount of depreciation deductions allowed with respect to certain passenger automobiles (sec. 280F of the Code) in the first year by \$9,200 (in lieu of the \$4,600 provided under the JCWAA) for automobiles that qualify (and do not elect out of the increased first year deduction). The \$9,200 increase is not indexed for inflation.

For property eligible for the present law 30-percent additional first year depreciation, the proposal extends the date of the placed in service requirement to property placed in service prior to January 1, 2006 (from January 1, 2005). Thus, property otherwise qualifying for the 30-

²¹ A taxpayer is permitted to elect out of the additional first-year depreciation deduction for any class of property for any taxable year.

²² An extension of the placed in service date of one year (i.e., January 1, 2007) is provided for certain property with a recovery period of ten years or longer and certain transportation property as defined for purposes of the JCWAA.

²³ Property does not fail to qualify for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to May 6, 2003. However, no additional first-year depreciation is permitted on any such component. No inference is intended as to the proper treatment of components placed in service under the 30% additional first-year depreciation provided by the JCWAA.

²⁴ For purposes of determining the amount of eligible progress expenditures, it is intended that rules similar to sec. 46(d)(3) as in effect prior to the Tax Reform Act of 1986 shall apply.

percent additional first year depreciation deduction will now qualify if placed in service prior to January 1, 2006. The proposal also extends the placed in service date requirement for certain property with a recovery period of ten years or longer and certain transportation property to property placed in service prior to January 1, 2007 (instead of January 1, 2006). In addition, progress expenditures eligible for the 30-percent additional first year depreciation is extended to include costs incurred prior to January 1, 2006 (instead of September 11, 2004).

Effective Date

The proposal applies to property placed in service after May 5, 2003.

B. Increase Section 179 Expensing

Present Law

Present law provides that, in lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to \$25,000 (for taxable years beginning in 2003 and thereafter) of the cost of qualifying property placed in service for the taxable year (sec. 179).²⁵ In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The \$25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$200,000. An election to expense these items generally is made on the taxpayer's original return for the taxable year to which the election relates, and may be revoked only with the consent of the Commissioner.²⁶ In general, taxpayers may not elect to expense off-the-shelf computer software.²⁷

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179.

Description of Proposal

The proposal provides that the maximum dollar amount that may be deducted under section 179 is increased to \$100,000 for property placed in service in taxable years beginning in 2003, 2004, 2005, 2006, and 2007. In addition, the \$200,000 amount is increased to \$400,000 for property placed in service in taxable years beginning in 2003, 2004, 2005, 2006 and 2007. The dollar limitations are indexed annually for inflation for taxable years beginning after 2003 and before 2008. The proposal also includes off-the-shelf computer software placed in service in a taxable year beginning in 2003, 2004, 2005, 2006, or 2007, as qualifying property. With respect to a taxable year beginning after 2002 and before 2008, the proposal permits taxpayers to make or revoke expensing elections on amended returns without the consent of the Commissioner.

²⁵ Additional section 179 incentives are provided with respect to a qualified property used by a business in the New York Liberty Zone (sec. 1400(f)) or an empowerment zone (sec. 1397A).

²⁶ Section 179(c)(2).

²⁷ Section 179(d)(1) requires that property be tangible to be eligible for expensing; in general, computer software is intangible property.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002.

C. Five-Year Carryback of Net Operating Losses

Present Law

A net operating loss (“NOL”) is, generally, the amount by which a taxpayer’s allowable deductions exceed the taxpayer’s gross income. A carryback of an NOL generally results in the refund of Federal income tax for the carryback year. A carryforward of an NOL reduces Federal income tax for the carryforward year.

In general, an NOL may be carried back two years and carried forward 20 years to offset taxable income in such years.²⁸ Different rules apply with respect to NOLs arising in certain circumstances. For example, a three-year carryback applies with respect to NOLs (1) arising from casualty or theft losses of individuals, or (2) attributable to Presidentially declared disasters for taxpayers engaged in a farming business or a small business. A five-year carryback period applies to NOLs from a farming loss (regardless of whether the loss was incurred in a Presidentially declared disaster area). Special rules also apply to real estate investment trusts (no carryback), specified liability losses (10-year carryback), and excess interest losses (no carryback to any year preceding a corporate equity reduction transaction).

The alternative minimum tax rules provide that a taxpayer’s NOL deduction cannot reduce the taxpayer’s alternative minimum taxable income (“AMTI”) by more than 90 percent of the AMTI (determined without regard to the NOL deduction).

Section 202 of the Job Creation and Worker Assistance Act of 2002²⁹ (“JCWAA”) provided a temporary extension of the general NOL carryback period to five years (from two years) for NOLs arising in taxable years ending in 2001 and 2002. In addition, the five-year carryback period applies to NOLs from these years that qualify under present law for a three-year carryback period (i.e., NOLs arising from casualty or theft losses of individuals or attributable to certain Presidentially declared disaster areas).

A taxpayer can elect to forgo the five-year carryback period. The election to forgo the five-year carryback period is made in the manner prescribed by the Secretary of the Treasury and must be made by the due date of the return (including extensions) for the year of the loss. The election is irrevocable. If a taxpayer elects to forgo the five-year carryback period, then the losses are subject to the rules that otherwise would apply under section 172 absent the provision.³⁰

²⁸ Sec. 172.

²⁹ Pub. Law No. 107-147.

³⁰ Because JCWAA was enacted after some taxpayers had filed tax returns for years affected by the provision, a technical correction is needed to provide for a period of time in which prior decisions regarding the NOL carryback may be reviewed. Similarly, a technical correction is needed to modify the carryback adjustment procedures of sec. 6411 for NOLs arising in 2001 and 2002. These issues were addressed in a letter dated April 15, 2002, sent by

JCWAA also provided that an NOL deduction attributable to NOL carrybacks arising in taxable years ending in 2001 and 2002, as well as NOL carryforwards to these taxable years, may offset 100 percent of a taxpayer's AMTI.³¹

Description of Proposal

The proposal extends the provisions of the five-year carryback of NOLs enacted in JCWAA to NOLs arising in taxable years ending in 2003, 2004, and 2005.³²

The proposal also allows an NOL deduction attributable to NOL carrybacks arising in taxable years ending in 2003, 2004, and 2005, as well as NOL carryforwards to these taxable years, to offset 100 percent of a taxpayer's AMTI.

Effective Date

The five-year carryback provision is effective for net operating losses generated in taxable years ending in 2003, 2004 and 2005.

The provision relating to AMTI is effective for NOL carrybacks arising in, and NOL carryforwards to, taxable years ending in 2003, 2004 and 2005.

the Chairmen and Ranking Members of the House Ways and Means Committee and Senate Finance Committee, as well as in guidance issued by the IRS pursuant to the Congressional letter (Rev. Proc. 2002-40, 2002-23 I.R.B. 1096, June 10, 2002).

³¹ Section 172(b)(2) should be appropriately applied in computing AMTI to take proper account of the order that the NOL carryovers and carrybacks are used as a result of this provision. *See* section 56(d)(1)(B)(ii).

³² Because certain taxpayers may have already filed tax returns (or be in the process of filing tax returns) for taxable years ending in 2003, the proposal contains special rules to provide until November 1, 2003, in which prior decisions regarding the NOL carryback may be reviewed by taxpayers.

III. DIVIDENDS AND CAPITAL GAINS

A. Reduce Individual Capital Gains Rates

Present Law

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain generally is included in income. Any net capital gain of an individual is taxed at maximum rates lower than the rates applicable to ordinary income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

Capital losses generally are deductible in full against capital gains. In addition, individual taxpayers may deduct capital losses against up to \$3,000 of ordinary income in each year. Any remaining unused capital losses may be carried forward indefinitely to another taxable year.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, (5) certain U.S. publications, (6) certain commodity derivative financial instruments, (7) hedging transactions, and (8) business supplies. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances that would have been available under the straight-line method of depreciation.

The maximum rate of tax on the adjusted net capital gain of an individual is 20 percent (10 percent with respect to income that would otherwise be taxed at the 10- or 15-percent rate). These rates apply for purposes of both the regular tax and the alternative minimum tax.

The "adjusted net capital gain" of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain. The net capital gain is reduced by the amount of gain that the individual treats as investment income for purposes of determining the investment interest limitation under section 163(d).

The term "28-percent rate gain" means the amount of net gain attributable to long-term capital gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to paragraph (3) thereof), an amount of gain equal to the amount of gain excluded from gross income under section 1202 (relating to certain small business stock),³³ the net short-

³³ This results in a maximum effective regular tax rate on qualified gain from small business stock of 14 percent.

term capital loss for the taxable year, and any long-term capital loss carryover to the taxable year.

“Unrecaptured section 1250 gain” means any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) held more than one year to the extent of the gain that would have been treated as ordinary income if section 1250 applied to all depreciation, reduced by the net loss (if any) attributable to the items taken into account in computing 28-percent rate gain. The amount of unrecaptured section 1250 gain (before the reduction for the net loss) attributable to the disposition of property to which section 1231 applies shall not exceed the net section 1231 gain for the year.

The unrecaptured section 1250 gain is taxed at a maximum rate of 25 percent, and the 28-percent rate gain is taxed at a maximum rate of 28 percent. Any amount of unrecaptured section 1250 gain or 28-percent rate gain otherwise taxed at a 15-percent rate is taxed at the 15-percent rate.

Any gain from the sale or exchange of property held more than five years that would otherwise be taxed at the 10-percent rate is taxed at an 8-percent rate. Any gain from the sale or exchange of property held more than five years and the holding period for which begins after December 31, 2000, which would otherwise be taxed at a 20-percent rate is taxed at an 18-percent rate.

Description of Proposal

The proposal reduces the 10- and 20-percent rates on the adjusted net capital gain to five and 15 percent, respectively. These lower rates apply to both the regular tax and the alternative minimum tax. The lower rates apply to assets held more than one year.

Effective Date

The proposal applies to taxable years ending on or after May 6, 2003, and beginning before January 1, 2013.

For taxable years that include May 6, 2003, the lower rates apply to amounts properly taken into account for the portion of the year on or after that date. This generally has the effect of applying the lower rates to capital assets sold or exchanged (and installment payments received) on or after May 6, 2003. In the case of gain and loss taken into account by a pass-through entity, the date taken into account by the entity is the appropriate date for applying this rule.

B. Dividend Income of Individuals Taxed at Capital Gain Rates

Present Law

Under present law, dividends received by an individual are included in gross income and taxed as ordinary income at rates up to 38.6 percent.³⁴

The rate of tax on the net capital gain of an individual generally is 20 percent (10 percent³⁵ with respect to income which would otherwise be taxed at the 10- or 15-percent rate).³⁶ Net capital gain means net gain from the sale or exchange of capital assets held for more than one year in excess on net loss from the sale or exchange of capital assets held not more than one year.

Description of Proposal

Under the proposal, dividends received by an individual shareholder from domestic corporations are treated as net capital gain for purposes of applying the capital gain tax rates. This treatment applies for purposes of both the regular tax and the alternative minimum tax. Thus, under the proposal, dividends will be taxed at rates of five and 15 percent, the same rates applicable to net capital gain.

If a shareholder does not hold a share of stock for more than 45 days during the 90-day period beginning 45 days before the ex-dividend date (as measured under section 246(c)),³⁷ dividends received on the stock are not eligible for the capital gain rates. Also, the capital gain rates are not available for dividends to the extent that the taxpayer is obligated to make related payments with respect to positions in substantially similar or related property.

If an individual receives an extraordinary dividend (within the meaning of section 1059(c)) eligible for the capital gain rates with respect to any share of stock, any loss on the sale of the stock is treated as a long-term capital loss to the extent of the dividend.

A dividend is treated as investment income for purposes of determining the amount of deductible investment interest only if the taxpayer elects to treat the dividend as not eligible for the capital gain rates.

The amount of dividends qualifying for capital gain rates that may be paid by a regulated investment company or real estate investment trust, for any taxable year that the aggregate qualifying dividends received by the company or trust are less than 95 percent of its gross

³⁴ Section 105 of the proposal reduces the maximum rate to 35 percent.

³⁵ An eight percent rate applies to property held more than 5 years.

³⁶ Section 301 of the proposal reduces the capital gain rates to five and 15 percent, respectively.

³⁷ In the case of preferred stock, the periods are doubled.

income (as specially computed), may not exceed the amount of the aggregate dividends received by the company or trust.

The capital gain rates do not apply to dividends received from an organization that was exempt from tax under section 501 or was a tax-exempt farmers' cooperative in either the taxable year of the distribution or the preceding taxable year; dividends received from a mutual savings bank that received a deduction under section 591; or deductible dividends paid on employer securities.

The tax rate for the accumulated earnings tax (sec. 531) and the personal holding company tax (sec. 541) is reduced to 15 percent.

Amounts treated as ordinary income on the disposition of certain preferred stock (sec. 306) are treated as dividends for purposes of applying the capital gain rates.

The collapsible corporation rules (sec. 341) are repealed.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2002, and beginning before January 1, 2013.

IV. MODIFICATION TO CORPORATE ESTIMATED TAX REQUIREMENTS

Present Law

In general, corporations are required to make quarterly estimated tax payments of their income tax liability (section 6655). For a corporation whose taxable year is a calendar year, these estimated tax payments must be made by April 15, June 15, September 15, and December 15.

Description of Proposal

With respect to corporate estimated tax payments due on September 15, 2003, 52 percent is required to be paid by October 1, 2003.

Effective Date

The proposal is effective on the date of enactment.