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What the new tax cuts mean to your clients

On May 28, 2003, President Bush signed into law tax cuts worth more than \$330 billion to American households.

While there are many facets to the law, here are some Frequently Asked Questions about the Jobs and Growth Tax Relief Reconciliation Act of 2003 that affect:

- [Marginal tax rates](#)
- [Dividends](#)
- [Capital gains](#)

Marginal tax rates

Q: How does the new tax law affect marginal tax rates?

A: Starting in 2003 and extending through 2010, marginal tax rates are lower.

2002 rates	2003–2010 rates
38.6%	35%
35%	33%
30%	28%
27%	25%
15%	15%
10%	10%

Because this provision “sunset” December 31, 2010, tax rates will revert to 2002 rates in 2011 unless the rate cuts are extended or made permanent.

More on this topic:

- > [What the new tax cuts mean to your clients](#)
- > [ICA shareholders may now cast their proxy votes online](#)
- > [The Bond Fund of America lowers its dividend](#)
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Dividends

Q: How does the new tax law affect the tax rates on dividends?

A: The new tax law lowers the tax rates on dividends that meet the definition of “qualified dividends.”

For taxpayers in income tax brackets higher than 15%, qualified dividends will be taxed at 15%. For taxpayers in the 10% and 15% tax brackets, qualified dividends will be taxed at 5% through December 31, 2007, and at 0% in 2008.

Because this provision “sunsets” December 31, 2008, tax rates will revert to 2002 rates in 2009 unless the rate cuts are extended or made permanent.

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Q: What is a qualified dividend?

A: For a dividend to be a qualified dividend, three conditions must be satisfied:

1. The dividend must be received between January 1, 2003, and December 31, 2008.
2. The dividend must be paid:
 - by a U.S. corporation (including mutual funds),
 - by a corporation incorporated in a U.S. possession,
 - by a foreign corporation located in a country that is eligible for benefits under a U.S. tax treaty that meets certain criteria, or
 - on a foreign corporation’s stock readily tradable on an established U.S. market (e.g., an American Depositary Receipt).
3. A specified holding period requirement must be met.

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Q: Will mutual funds pay qualified dividends?

A: Yes, a mutual fund generally can pass on the qualified dividends it receives.

Q: How will shareholders know if they received qualified dividends from American Funds?

A: Shareholders will receive this information on their 2003 Form 1099-DIV, mailed in January 2004.

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Q: Do mutual fund shareholders have to meet a holding period requirement?

- A:** Yes. To be eligible to treat all or a portion of a fund's dividend as qualified, a shareholder must have held the fund's shares for more than 60 days during a 120-day period that begins 60 days before the fund's ex-dividend date.

For example, Kate purchased shares of a mutual fund 60 days before its ex-dividend date. For a dividend to be qualified, she cannot sell her shares until the day after its ex-dividend date. Mark purchased shares of a mutual fund two days before its ex-dividend date. For the dividend to be qualified, he will have to hold his shares at least 59 days after the ex-dividend date.

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Q: Will all dividends paid by a mutual fund be qualified dividends?

- A:** No. A mutual fund may also pay income dividends that are not qualified, consisting of non-qualified corporate dividends (e.g., dividends received by the fund before January 2003 and dividends paid by certain foreign corporations), interest income and net short-term capital gains.

Q: What is the tax rate on dividends that are not qualified dividends?

- A:** Dividends that are not qualified dividends will be taxed at the appropriate marginal tax rate for ordinary income.

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Q: Can American Funds estimate what portion of a fund's dividend will be qualified before the end of the calendar year?

- A:** Listed below are preliminary estimates (through May 31, 2003) of the percentage of our funds' income that will qualify for the lower rates. Please keep in mind that growth funds with low dividend rates will not produce significant amounts of qualified dividends despite a high qualifying percentage.

We will send these estimates to financial advisers with the July issue of *The Flyer*. Shareholders with taxable accounts will also receive estimates in their June 30 account statements. Because these estimates may change throughout the year as the fund earns different types of income, we will provide updated estimates later this year.

Funds expected to pay qualified dividends

	Estimated percentage of qualified dividends as of 5/31/03*
Growth funds	
AMCAP Fund	100%
EuroPacific Growth Fund	100%
The Growth Fund of America	100%
The New Economy Fund [†]	100%
New Perspective Fund	100%

New World Fund	90%
SMALLCAP World Fund [†]	100%
Growth-and-income funds	
American Mutual Fund	85%
Capital World Growth and Income Fund	90%
Fundamental Investors	100%
The Investment Company of America	75%
Washington Mutual Investors Fund	100%
Equity-income funds	
Capital Income Builder	55%
The Income Fund of America	40%
Balanced fund	
American Balanced Fund	65%

* These percentages represent only preliminary partial-year estimates (1/1/03–5/31/03). The final percentages for 2003 could vary.

[†] May not pay dividends in 2003.

Funds not expected to pay qualified dividends

Because the income of the following funds is from bonds, money market instruments and non-dividend paying investments, we do not expect these funds to pay qualified dividends. All dividends paid by these funds will be taxed at ordinary income rates.

- American High-Income Municipal Bond Fund
- American High-Income Trust
- The Bond Fund of America
- Capital World Bond Fund
- The Cash Management Trust of America
- Intermediate Bond Fund of America
- Limited Term Tax-Exempt Bond Fund of America
- The Tax-Exempt Bond Fund of America
- The Tax-Exempt Fund of California
- The Tax-Exempt Fund of Maryland
- The Tax-Exempt Fund of Virginia
- The Tax-Exempt Money Fund of America
- U.S. Government Securities Fund
- The U.S. Treasury Money Fund of America

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Q: How will the foreign tax credit be affected by qualified dividends?

A: Generally, the amount of the foreign tax credit a shareholder can claim will not be affected by qualified dividends. However, for a shareholder who claims a foreign tax credit above \$300 (single filer) or \$600 (joint filer), the shareholder's foreign tax credit may be limited. Shareholders should consult their tax adviser for more information.

Q: How will the lower tax rates on qualified dividends impact estimated taxes?

- A:** Every shareholder's tax situation is unique. As a result, we strongly urge shareholders to consult their tax adviser to find out how the lower tax rates on qualified dividends may impact their estimated tax payments.

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Capital gains

Q: How does the new tax law affect the tax rates on capital gains?

- A:** Generally, the tax rates on long-term capital gains are lower.

The maximum tax rate on long-term capital gains (defined as gains on assets held for more than one year) was lowered from 20% to 15%. For taxpayers in the 10% and 15% tax brackets, long-term capital gains will be taxed at 5% through December 31, 2007, and at 0% in 2008.

Because this provision "sunset" December 31, 2008, tax rates will revert to 2002 rates in 2009 unless the rate cuts are extended or made permanent.

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Q: What is the tax rate on capital gains that are not long-term?

- A:** Short-term capital gains (gains on assets held for one year or less) are subject to a taxpayer's ordinary income rates.

Q: Are all long-term capital gains now subject to the lower tax rates?

- A:** Only long-term capital gains from sales or exchanges made after May 5, 2003, and before December 31, 2008, will be eligible for the lower tax rates.

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Q: How does the new tax law affect the lower capital gains rates on "qualified five-year gains?"

- A:** The tax rate depends upon the date of the sale or exchange.
- **Sales or exchanges from January 1, 2003, through May 5, 2003**, that result in qualified five-year gains may be eligible for the reduced 8% rate for taxpayers in the 10% and 15% tax brackets.
 - **For sales or exchanges from May 6, 2003, through December 31, 2007**, the qualified five-year gain rule is repealed, and long-term capital gains will be taxed at the lower 15% and 5% rates.
 - **For sales or exchanges from January 1, 2008, through December 31, 2008**, the qualified five-year gain will be taxed at 0% for shareholders in the 10% and 15% tax brackets.
 - **For sales or exchanges after December 31, 2008**, the rates on long-term capital gains return to the 20% and 10% levels. However, gains on sales or exchanges of

assets held for more than five years will be eligible for the reduced tax rates of 18% or 8%, respectively, under the qualified five-year gain rules.

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Q: How will mutual fund capital gain distributions be taxed?

A: A mutual fund will be able to pass on to its shareholders net long-term capital gains that qualify for the lower tax rates under the new law. Long-term capital gains realized by a fund prior to May 6, 2003, will not be eligible for the lower tax rates.

Q: How will the lower tax rates on capital gains impact estimated taxes?

A: Every shareholder's tax situation is unique. As a result, we strongly urge shareholders to consult their tax adviser to find out how the lower tax rates on capital gains may impact their estimated tax payments.

Q: How will I know what portion of my capital gain distribution is eligible for the lower tax rates?

A: The Internal Revenue Service is modifying the 2003 Form 1099-DIV to show the amount of a capital gain distribution eligible for the reduced capital gains rates.

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