

The 2004 Working Families Act and the American Jobs Creation Act of 2004

Congress recently passed the 2004 Working Families Act (WJA) and the American Jobs Creation Act (AJC) of 2004. The AJC was signed into law by President Bush on Friday, October 22, 2004. We have prepared a brief explanation of the pertinent provisions contained in these Acts for individual and business taxpayers.

Individual Provisions

Child tax credit

The child tax credit, which is \$1,000 per child for 2004 but was scheduled to drop to \$700 for 2005 through 2008 and to rise to \$800 for 2009, will stay at \$1,000 through 2010.

Marriage penalty relief

Two provisions that provide a measure of relief from the marriage penalty are extended. The provision setting the standard deduction for joint filers at twice that of single taxpayers, and the provision that increases the size of the 15% rate bracket for married couples filing joint returns, both of which were due to expire at the end of 2004, are extended through 2010.

Ten percent (10%) bracket

The scheduled reduction in the amount of income subject to the 10% tax bracket is repealed, effective through 2010.

Higher exemption amount extended

In recent years, Congress has provided a measure of relief from the Alternative Minimum Tax (AMT) by raising the AMT "exemption amounts," thereby reducing the likelihood of an AMT liability. However, this partial relief was set to expire for tax years beginning after 2004, and the exemption amounts were scheduled to revert to the lower amounts allowed under prior law. The Act preserves this partial relief from the AMT by extending the higher exemption amounts to 2005.

Deduction of state and local general sales taxes

In a move that will primarily benefit individuals in states with sales taxes but with no or limited individual income taxes, (i.e., AK, FL, NV, NH, SD, TN, TX, WA and WY), taxpayers, who can itemize their deductions, will be able to deduct on their

federal tax returns for 2004 and 2005 either what they pay in state and local income taxes or what they pay in sales taxes (typically, the greater of the two). Previously, only state and local income tax payments were deductible. Taxpayers who itemize may deduct their actual sales taxes or use IRS-published tables. Taxpayers opting to use the IRS tables will have the ability to also deduct sales taxes for certain "big ticket" items such as boats, vehicles and other items to be listed by the IRS.

Limitations on charitable deductions of vehicles

Generally, no deduction will be allowed for the contribution of a vehicle, unless the contribution is substantiated by a contemporaneous written acknowledgement from the donee organization containing certain information and certification(s), and the acknowledgement is included with the tax return on which the deduction is claimed. The amount of the deduction will be limited to the gross sales proceeds, should the organization sell the vehicle without any significant intervening use or material improvement.

Non-qualified deferred compensation

The AJC makes it difficult for plan participants to defer tax on non-qualified deferred compensation for amounts deferred in tax years beginning after 2004. If at any time during the year, a plan does not meet certain operational standards, the participant must recognize all income deferred from the current and prior years.

Business Provisions

Repeal of exclusion for extraterritorial income

At the heart of the AJC is the repeal of the exclusion for Extraterritorial Income (ETI). Specifically, the AJC repeals the ETI system of tax benefits for transactions after 2004, with transition relief for 2005 and 2006 and grandfather rules for contracts entered into before Sept. 18, 2003.

New deduction for U.S. production activities

The AJC replaces ETI with a new tax break for

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domestic production activities. The deduction is a percentage of the net income from those activities—3% in 2005-2006, 6% for 2007-2009, 9% after 2009. (The 9% deduction percentage is intended to be equivalent to a 3% rate cut).

The U.S. production activities deduction is allowed with respect to a taxpayer's qualified production activities income, which is the taxpayer's domestic production gross receipts net of expenses. "Domestic production gross receipts" are receipts derived from the following:

- Any lease, rental, license, sale, exchange, or other disposition of:
 - ... qualifying production property (i.e., tangible personal property, any computer software, and certain sound recordings that was manufactured, produced, grown, or extracted in whole or in significant part by the taxpayer within the U.S.;
 - ... any qualified film produced by the taxpayer; or
 - ... electricity, natural gas, and potable water produced by taxpayers in the U.S.
- Construction performed in the U.S.
- Engineering and architectural services performed in the U.S. for construction projects in the U.S.

The deduction is available to all taxpayers with qualified production activities income. For pass-thru entities (such as S corporations and partnerships), the deduction generally is determined at the shareholder or partner level by taking into account their proportional share of the qualified production activities income of the entity.

Tax reform and simplification for U.S. businesses with foreign earnings

The AJC includes several provisions to reduce double taxation of U.S.-based companies, including reducing the Foreign Tax Credit (FTC) baskets from nine to two and allowing FTCs to be carried forward for 10 years instead of five.

The AJC repeals the 90-percent limitation on the use of FTCs against AMT.

The AJC encourages companies to reinvest foreign earnings in the U.S. by temporarily allowing an 85% dividends-received deduction on distributions from controlled foreign corporations.

Business tax incentives

The Acts have a number of business related incentives including:

- an extension for two years the increased Code Sec. 179 expensing so qualifying businesses can immediately expense over \$100,000 (with indexing) of new investments through 2007.
- 15-year write-off for qualifying leasehold improvements and restaurant property.
- 10 provisions that make it easier for businesses to qualify and operate as a S corp, including raising the maximum number of shareholders from 75 to 100 and allowing family members to be counted as one shareholder.
- limiting the amount of the cost of a SUV that may be expensed in a single year to \$25,000, effective for vehicles placed in service after October 22, 2004.
- an extension of the research credit, extended for amounts paid or incurred after June 30, 2004 and before 2006.
- an extension of the work opportunity tax credit and the welfare-to-work credit, extended for wages paid or incurred for individuals beginning work after 2003 and before 2006.
- an extension of the enhanced deduction for a corporation's qualified computer contributions, for contributions made in tax years beginning after 2003 and before 2006.
- suspending the net-income limitation on percentage depletion for marginal wells, effective for tax years beginning after 2003 and before 2006.

Please keep in mind that we highlighted the most important changes in the new law. Many of these changes may provide tax planning opportunities as we near the end of 2004. Please contact us for more details on how you may benefit from these important pieces of tax legislation.



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