

AMERICAN JOBS CREATION ACT OF 2004

The American Jobs Creation Act of 2004 was passed after more than two years of struggling to reach agreement on its main provision, the repeal of the tax subsidies for U.S. companies that export products abroad. The World Trade Organization had ruled the subsidies to be illegal and began charging penalties on U.S. exports.

The law, which President Bush signed on October 22, 2004, repealed the subsidies and replaced them with tax breaks for U.S. companies. The bill also became the vehicle for many unrelated tax provisions. The result is a 650-page law with more than 270 changes to the tax code. Though the major impact of the law is on big corporations, this 2004 legislation will have a significant effect on small businesses, farmers, real estate investors, and individual taxpayers.

Here is an overview of the law's major provisions.

REPEAL OF FSC/ETI TAX REGIME

- ❖ The foreign sales corporation/extraterritorial income (FSC/ETI) rules are gradually repealed, starting in 2005. Generally, taxpayers may claim 100% of their FSC/ETI benefits in 2004, 80% in 2005, 60% in 2006, and 0% effective in 2007.
- ❖ The export subsidies are replaced by a new deduction for manufacturers. Initially, the deduction is 3% of the lesser of (a) qualified production activity income for the year, or (b) taxable income for the year. The deduction is gradually phased in until it reaches 9% in 2010. It is limited to 50% of W-2 wages paid during the tax year.
- ❖ The new law defines "manufacturer" very broadly. The IRS expects to issue extensive new guidance to define and clarify just what activities constitute "production activities" that qualify for the deduction.

FIRST-YEAR EXPENSING AND DEPRECIATION RULES

- ❖ The first-year expensing limit of \$100,000 (adjusted annually for inflation) is extended through 2007. Under prior law, the limit would have reverted to \$25,000 in 2006.
- ❖ First-year expensing for sport utility vehicles is limited to a maximum of \$25,000. This limit applies to vehicles weighing not more than 14,000 pounds and is effective for vehicles first used in business after the law's enactment date.
- ❖ The depreciation period for qualified leasehold improvements to nonresidential real property and qualified restaurant property placed in service after the law's date of enactment and before 2006 is reduced from 39 years to 15 years.

S CORPORATION RULES

- ❖ The number of shareholders allowed in an S corporation is increased from 75 to 100. Shareholders who are family members are combined and treated as one shareholder.
- ❖ Traditional and Roth IRAs will be allowed to hold shares in banks that are S corporations.
- ❖ Several other rules governing S corporations are relaxed; these changes are likely to make the already popular legal entity even more attractive to businesses.

STATE SALES TAX DEDUCTION

- ❖ Individuals will be allowed to take an itemized deduction on their federal income tax return for state and local sales taxes in lieu of a deduction for state and local income taxes. This option is available for 2004 and 2005.
- ❖ This change will be especially beneficial to taxpayers in the seven states that do not have a state income tax. The deduction is available in all states, however, and will be useful when the taxpayer has made major purchases during the year that result in paying higher sales tax than state income tax.
- ❖ The deduction is not available to those who take the standard deduction on their federal income tax return. Also, the benefit of this deduction may be lost for those who are subject to the alternative minimum tax, since a deduction for state and local taxes is not allowed in calculating the AMT.
- ❖ Taxpayers may determine the amount of the sales tax deduction either by keeping receipts or by using tables that the IRS will provide.

DONATIONS TO CHARITY

- ❖ The deduction rules for donating vehicles to charity are tightened. If the charity sells a donated vehicle, the taxpayer may deduct the amount of gross proceeds from the sale (usually far less than "blue book" value). If the charity keeps and uses the vehicle, the organization must provide the taxpayer with an estimated value of the vehicle. Charities that do not meet the law's reporting requirements will be subject to stiff penalties.
- ❖ The deduction allowed for the contribution of a patent or other intellectual property is limited to the taxpayer's basis in the contributed property or its fair market value, whichever is lower. An additional deduction is allowed for a percentage of the income the charity receives from the donated property.

OTHER PROVISIONS

- ❖ A provision in the law permits companies with overseas operations to bring profits back to the U.S. at a 5.25% tax rate for one year.
- ❖ The law includes a number of tax breaks for farmers. When weather forces the sale of livestock, farmers will have four years (up from two years) to defer gain by reinvesting in similar livestock. The law also provides for a \$10 billion fund to buy out tobacco farmers.
- ❖ The law has several provisions aimed at curbing abusive tax shelters and increasing penalties for shelter promoters and participants.
- ❖ The law gives the IRS authority to use private debt collectors to collect federal tax debt.

If you have questions about how these tax changes will affect you or your business, please contact L.F. Harris & Associates, CPA, P.A. at 407-228-0560.