

## **2004 TAX LEGISLATION**

Dear Clients and Friends:

We are writing to update you on two major tax laws that have just passed Congress: the *American Jobs Creation Act of 2004* and the *Working Families Tax Relief Act of 2004*. Both have important ramifications for virtually all business and individual taxpayers. Of the two acts, the *American Jobs Creation Act of 2004* is by far more complicated and far reaching tax law. In fact, it is being called the most massive tax bill for the business community since 1986.

This letter will introduce you to some of the major changes that have taken place. Most of the changes present opportunities for you and your business to save more taxes. Some, however, set traps for the unwary; while others are outright attempts to wring a few more tax dollars out of the business community.

### **INDIVIDUALS**

#### **Working Families Tax Relief Act of 2004**

***Child Credit.*** Parents of children under 17 may continue to claim a \$1,000 child tax credit for every child through 2010. Without the new law, the child credit would have dropped to \$700 per child in 2005.

***Marriage Penalty Relief.*** Married taxpayers filing jointly will benefit from marriage penalty relief through 2010. The so called "marriage penalty" comes into play when both spouses have income, since the tax on the couple's combined income on a joint return exceeds the taxes that would be imposed if each file a separate return. Relief comes by increasing the basic standard deduction amount for married couples filing a joint return to twice the basic standard deduction for single returns and by increasing the size of the 15-percent bracket. For 2005 joint tax returns, this means having the high end of the 15 percent tax bracket pegged at \$59,400, rather than at \$53,450 and a standard deduction of \$10,000 instead of \$8,700.

## **American Jobs Creation Act of 2004**

**Vehicle Donations.** Congress voted to dramatically limit the deduction for vehicles contributed to charity. If the charity sells your vehicle without using and improving it (which is usually the case under most vehicle-donation programs), your charitable deduction cannot exceed the gross proceeds that it receives from the sale, usually a deeply discounted below-wholesale price. Stiff penalties will be imposed on charities that don't approach this obligation honestly. The charity also is required to pass along to the IRS the information in a written acknowledgement that it is required to give to the donor.

The new acknowledgement rule for arm's-length sales applies for contributions made after December 31, 2004.

**State Sales Tax Deductions.** The new law allows individuals to deduct state sales taxes instead of deducting state and local income taxes as an itemized deduction. This election is available in 2004 and 2005. If you elect to deduct state and local sales taxes paid, you will have two options: determine the deductible amount by accumulating receipts, or by using tables to be prepared by the Secretary of the Treasury based on average consumption and other factors.

This deduction is available for all states, including states without an income tax. If you make several major purchases for the year, such as a luxury car or boat, you may find that electing to deduct sales tax will pay off if you combine those purchases with daily sales tax expenses. Because this election is available for entire 2004 tax year, getting organized and finding your sales receipts since January 1, 2004, should be a priority.

## **BUSINESSES**

**New Deduction for Manufacturers.** Even if you do not believe you are a manufacturer, this new deduction may be for you. Four years ago, the World Trade Organization declared the FSC/ETI (foreign sales corporation/extraterritorial income) tax regime for exporters an illegal trade subsidy and began to impose high import duties on certain American exports. In response, Congress has repealed that system (over a four-year period). In its place, it is approved a new deduction for manufacturers.

The new deduction for manufacturers, which itself is phased in gradually over six years, surprised many experts. It covers all income from manufacturing in the United States, not only for export businesses. It represents up to a 3 percentage point drop in a business's effective tax rate. What's more "manufacturing" is defined very broadly to include not only traditional manufacturing, but also construction, engineering, energy production, computer software, filmmaking, and the processing of agricultural products. Corporations, individuals, S corporations, partnerships, estates, trusts and cooperative can take advantage of the new deduction.

The deduction is equal to three percent of your income tax years beginning in 2005 and 2006, six percent of your income for tax years beginning 2007, 2008 and 2009; and for tax years beginning after 2009, the deduction is equal to nine percent of your income. The deduction is limited to the least of (1) your qualified production activities income, (2) your taxable income for the tax year, or (3) 50 percent of wages paid by you during the calendar year ending in your tax year. You may also use the deduction for purposes of the alternative minimum tax.

**Small Business Expensing and Depreciation.** Two years ago, Congress raised the threshold for small business expensing from \$25,000, to \$100,000. The enhanced treatment was designed as a temporary measure to stimulate the economy, falling back to \$25,000 in 2006. The new law extends the higher small business expensing amounts through 2007.

**The SUV Deduction.** Large sports utility vehicles and luxury passenger trucks may no longer be driven through a large tax loophole by business owners. Because the vehicle caps on depreciation do not apply to cars or trucks weighing more than 6,000 pounds, taxpayers could deduct up to the full cost of the SUV immediately as a section 179 deduction. Now the deduction for vehicles weighing not more than 14,000 pounds is capped at \$25,000, effective for property placed in service after October 22, 2004. However, that is still much higher than the cap placed on “regular vehicles,” which hovers around that \$3,000 level.

**Depreciation.** Congress approved a 15-year recovery period, using straight-line depreciation, for qualified leasehold improvements to *nonresidential real property*. The new law also provides a 15-year recovery period and straight-line depreciation for qualified restaurant property. These new rules apply to improvements placed in service between October 22, 2004 and January 1, 2006.

**S Corporation Reform.** The new law changes the S corporation rules. The permissible number of S corporation shareholders increases from 75 to 100, and all members of a family (formerly, only husband and wife) are treated as one S corporation shareholder. If you own a family business, this can represent a significant tax break.

If you have any questions or would like to schedule an appointment, please contact us.

Very truly yours,

Palermo Kissinger & Associates