2004 Tax Legislation: Tax Breaks for Business

There are 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 to virtually every business. Of the two, the *American Jobs Creation Act of 2004* is the more complicated and extensive. In fact, it is considered the most important tax bill for the business community since 1986.

This letter will introduce you to some of the major changes that have taken place in connection with the tax law's application to business entities and business operations. Most of the changes present opportunities for 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.

New deduction for manufacturers. Even if you don't think 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 slap high fines on those businesses. In response, Congress has repealed that system (over a four-year period). In its place, it 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 from 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 cooperatives can take advantage of the new deduction.

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 will no longer be able to 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 a lot more than the cap placed on "regular vehicles," which hovers around the $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.

S corporation reform. The new law dramatically changes the S corporation rules. Under the recent legislation, the permissible number of S corporation shareholders increases from 75 to 100. In addition, Congress also approved treating all members of a family as one S corporation shareholder. If you own a family business, this can represent a significant tax break.

The new law also permits traditional and Roth IRAs to hold shares in a bank that is an S corporation; allows suspended losses or deductions to be transferred in the case of transfers of stock to a spouse incident to divorce; eases the rules for determining potential current beneficiaries of an electing small business trust; relaxes some passive activity loss rules as they relate to qualified subchapter S trusts; gives relief from inadvertent invalid subchapter S subsidiary elections and terminations; and provides for qualified subchapter S subsidiaries to file information returns.

International tax reform. If you do business abroad, you will need to react to the American Jobs Creation Act in many different ways. Congress approved reducing the number of foreign tax credit baskets from nine to two: passive category income and general category income. The new law also delineates some financial services income as general category income and allows taxpayers to make a temporary election about certain creditable foreign taxes. Congress also approved changes to the interest expense allocation rules for the foreign tax credit limitation. An actual list of all the changes in this area literally goes on for pages.

Tax breaks for farmers. Agribusiness as well as traditional farmers make out well under the new tax laws. In addition to qualifying the processing of agricultural products as "manufacturing" eligible for the three-percent corporate tax reduction, the new law adds over 20 agricultural tax breaks and incentives to the Code, including significant provisions affecting weather-forced livestock gain and the alternative minimum tax as applied specifically to the usual ups and downs of farm income from year to year.

Extended business credits and deductions. The Working Families Tax Relief Act of 2004 is not just for families. An entire section of this new law extends over 20 temporary business incentives, which either had expired at the end of 2003 or at the 2004 midpoint. These include the research credit, the welfare-to-work and work opportunity tax credits, environmental remediation expensing, which is extended for expenses paid or incurred after 2003 and before 2006, and the renewable source energy credit.

Revenue Raisers. Not all of the provisions in the new tax laws are favorable. Over $100 billion in "revenue raising" provisions temper the celebration. These provisions also form a long list and need to be monitored. Under the new legislation, tax shelter investors have been asked to pay up with increased penalties; the personal use of company aircraft by the company's executive/owners can no longer be deducted by the business in an amount that is greater than what is considered compensation to the employee; and the size of vehicle donations, whether by a business or an individual, also has been severely restricted, effective starting in 2005.

An invitation

The latest two tax laws are about change, over $200 billion for business doled out by over 700 pages of amendments to the Internal Revenue Code. Change brings new opportunities, new headaches, new pitfalls, and new reasons to revisit previous plans and strategies. Fortunately, the latest tax laws easily tip the scales toward the positive and overall promise "to put more money in your pocket." Please give our office a call. We can schedule an appointment to discuss what step to take for you and your business to maximize the tax benefits in the new tax legislation.