



American Jobs Creation Act of 2004 – HR 4520

Signed by President Bush – October 22, 2004

Unless otherwise noted, the provisions of this bill are effective for taxable years beginning after the date of enactment, October 22, 2004.

Background

The *American Jobs Creation Act of 2004* is being labeled the most significant reform of U.S. business taxation, in terms of both impact and number of provisions, since the Internal Revenue Code was revised in 1986. The *Act* was passed by the House on October 7, 2004, and then passed by the Senate on October 11, 2004.

The incentive for the long awaited legislation was the repeal of the extraterritorial income (ETI) taxing regime. The ETI provisions were believed to violate international trade agreements by the World Trade Organization back in January of 2002. In March 2004, the European Union started imposing multi-million dollar sanctions on the United States. The *American Jobs Creation Act of 2004* signals the end of the imposition of these sanctions.

The bill began as an effort to compensate exporters for the repeal of the \$50 billion tax-based trade subsidy; however, it ballooned into a \$145 billion package of pre-election business tax breaks. The major impact of this massive legislation is made by the broad-based corporate incentives and tax cuts originally intended to compensate U.S. businesses for the ETI repeal. U.S. manufacturers, multinational operations, agribusiness, and energy companies will all greatly benefit from the legislation, although small businesses, farmers, partnerships, S corporations, and real estate investors will reap some benefits as well.

The effective dates of these provisions vary. Some provisions are retroactive, some become effective on the date the President signs the bill, some take effect next year, and still others are not implemented until 2006.

Here are some of the more significant provisions of the *American Jobs Creation Act of 2004*:

- Repeal the controversial extraterritorial income (ETI) taxing regime;
- Create a new business deduction for U.S. manufacturers effectively reducing their income tax rate;

Summary provided by National Association of Tax Professionals (NATP).



- Continue enhanced small business expensing for two more years;
- Significantly narrow the SUV loophole by capping the related deduction;
- Accelerate depreciation for leasehold and restaurant improvements;
- Reform S corporation taxation including expanding the permissible number of shareholders;
- Attempt to simplify international taxation in part by reducing the foreign tax credit baskets from nine to two;
- Provide tax relief to farmers and agricultural businesses;
- Crack down on tax shelters and other tax avoidance schemes including leasing transactions;
- Tighten the rules surrounding charitable deductions for vehicle donations; and
- Allow deductions of state sales tax in lieu of deductions of state income tax.

Summary

This summary will focus primarily on the tax changes affecting individual taxpayers and small business owners.

I. Individuals

Election to deduct state and local general sales taxes in lieu of state and local income taxes – For tax years beginning after 2003 and before 2006, individual taxpayers may now elect to deduct *either* state and local income taxes *or* state and local general sales taxes as an itemized deduction on their federal income tax returns. The amount to be deducted is *either*:

1. The total of actual general sales taxes paid as substantiated by accumulated receipts, *or*
2. An amount from IRS-generated tables plus, if any, the amount of general sales taxes paid in the purchase of a motor vehicle, boat, or other items as prescribed by the Secretary.

The deduction is subject to the phase-out limitation on itemized deductions for taxpayers with adjusted gross income over specified amounts.

State and local income taxes are an alternative minimum tax (AMT) adjustment to the alternative minimum taxable income (AMTI). Since taxpayers are electing to substitute state and local general sales taxes for state and local income taxes, and since new §164(b)(5) is silent regarding AMT, it is assumed that if the



deduction for general sales taxes is elected, this amount will need to be added back to adjusted gross income to determine AMTI. Taxpayers in states with no state wide income tax (Alaska, Florida, New Hampshire, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming) who elect to deduct the general sales taxes paid may now become subject to AMT. These provisions are effective for tax years beginning after December 31, 2003.

Period of ownership for home acquired in like-kind exchange – When an individual acquires a principal residence in a like-kind exchange, that individual must own the property for at least five years prior to its sale or exchange in order for the exclusion of gain rule to apply. Formerly, if the principal residence was acquired in a like-kind exchange, the individual need only own the property for two years before the exclusion provision generally became available. The ownership period must now be at least five years, dating from the day that the property was acquired. The two-year ownership rule continues to apply to other types of acquisitions such as purchases.

Above-the-line deduction for attorneys' fees and court costs incurred in civil rights suits – A deduction is allowed from gross income for attorneys' fees and court costs incurred by, or on behalf of, an individual in connection with any action involving:

1. A claim of unlawful discrimination as defined in §62(e);
2. Claims against the federal government under Subchapter III of Chapter 37 of Title 31, United States Code; or
3. A private cause of action under the Medicare Secondary Payer statute.

The above-the-line deduction is limited to the amount includible in the individual's gross income for the tax year (whether paid in a lump sum or in periodic payments) on account of a judgment or settlement (whether by suit or agreement) resulting from the claim. Because a deduction that qualifies under the new provision is above-the-line, affected attorneys' fees and court costs are no longer subject to the reduction in itemized deductions for high-income individuals, and can be claimed for alternative minimum tax (AMT) purposes.

Certain expenses of rural mail carriers – United States Postal Service employees who perform services involving the collection and delivery of mail on rural routes and who receive qualified reimbursements for automobile expenses incurred in performing these services may deduct their actual automobile expenses that exceed the qualified reimbursement amount. The deduction is claimed as a miscellaneous itemized deduction, subject to the two percent of adjusted gross



income limitation. This amendment is effective for tax years beginning after December 31, 2003.

National Health Services Corps Loan Repayments – National Health Service Corps (NHSC) Loan Program repayments made to health care professionals are excluded from gross income and employment taxes. Loan repayments received under similar state programs eligible for funds under the *Public Health Service Act* are also excluded from income and employment taxes. Repayment amounts excluded will not be taken into account as wages for purposes of determining a recipient's social security benefits.

Under the NHSC Loan Program, health care professionals participating in the program may receive repayment of their educational loans. To qualify for payment, the participant is required to provide medical services in a geographic area identified by the Public Health Service as having a shortage of health care professionals. The provision applies to amounts received by an individual in tax years beginning after December 31, 2003.

90 percent limit on AMT foreign tax credit repealed – The 90 percent limit on use of the alternative minimum tax-foreign tax credit (AMT-FTC) to offset alternative minimum tax (AMT) is repealed. As a result, taxpayers now have full use of alternative minimum tax-foreign tax credits in computing AMT. Taxpayers must still apply regular tax FTC limitations in computing the AMT-FTC, even though the AMT-FTC, as so computed, may fully offset AMT.

Foreign tax credit carryover extended to 10 years, foreign tax credit carryback limited to one year – The excess foreign tax credit carryforward period for both income taxes and foreign oil and gas extraction taxes has been extended to 10 years and limited to a carryback period of one year.

Installment payments of tax – This provision clarifies that the IRS is authorized to enter into installment agreements with taxpayers which do not provide for full payment of the taxpayer's liability over the life of the agreement. This provision also requires the IRS to review partial payment installment agreements at least every two years.

Deposits may be made to suspend interest on potential underpayments – Taxpayers are now to make a cash deposit with the IRS for future application against an underpayment of income, gift, estate, or generation-skipping tax which has not been assessed at the time of the deposit. Deposits may also be made for future application against underpayments of excise taxes imposed by Internal



Revenue Code Chapter 41 (Public Charities), Chapter 42 (Private Foundations, Black Lung Benefit Trusts, Section 501(c)(3) organizations, Excess Benefit Transactions), Chapter 43 (Pension Plans), or Chapter 44 (Qualified Investment Entities).

To the extent that a deposit is used by the IRS to pay a tax liability, the tax is treated as paid when the deposit is made and no interest underpayment is imposed. Furthermore, if the dispute is resolved in favor of the taxpayer or the taxpayer withdraws the deposited money before resolution of the dispute, interest is payable on the deposit at the federal short-term rate.

The provision applies to deposits made after October 22, 2004.

Use of private debt collection agencies – The IRS, like other federal agencies is allowed to use private debt collection (PDC) agencies to recover federal debts while providing safeguards for taxpayers' rights and privacy. PDCs may be used to locate and contact taxpayers owing outstanding tax liabilities of any type and to arrange payment of those taxes. In order to refer a taxpayer's account, the IRS must have made an assessment pursuant to §6201.

II. Charitable Contributions

Substantiating vehicle donations – The reporting requirements for charitable contributions of most vehicles have been increased. A charitable deduction under §170(a) will be denied to any taxpayer that fails to obtain a written acknowledgement for any "qualified vehicle" donation if the claimed value of the vehicle exceeds \$500. Once the claimed value of the vehicle donation exceeds \$500, the new substantiation requirements replace the substantiation requirements that apply to contributions with claimed values of \$250 or more.

For this purpose, a "qualified vehicle" includes any:

1. Motor vehicle that is manufactured primarily for use on public streets, roads, or highways;
2. Boat; or
3. Aircraft

The term "qualified vehicle" does not include any inventory property.

The written acknowledgement must be provided to the donor by the donee organization within 30 days of the contribution of the qualified vehicle, or the date



of sale of the qualified vehicle by the donee organization if it sells the vehicle without any significant intervening use or material improvement.

The acknowledgement must contain the name and taxpayer identification number of the donor and the vehicle identification (or similar) number. It must also include:

1 - If the donee organization sells the qualified vehicle without any significant intervening use or material improvement:

- A certification that the vehicle was sold in an arm's-length transaction between unrelated parties;
- The gross proceeds of the sale; and
- A statement that the deductible amount may not exceed the gross proceeds, or

2 - If the donee organization retains the qualified vehicle for its usage:

- A certification stating the intended use of the vehicle or any material improvement intended for the vehicle, and the intended duration of such use; and
- A certification that the vehicle will not be transferred in exchange for money, property, or services prior to completion of the intended use or improvement.

If the donee organization sells the qualified vehicle without any significant intervening use or material improvement, the maximum deduction the taxpayer will be allowed under §170(a) will be equal to the gross proceeds received by the donee organization from the sale of that qualified vehicle.

These amendments are applicable to contributions made after December 31, 2004.

Increased reporting for noncash charitable contributions – The reporting requirements for noncash charitable contributions have been increased. A charitable deduction under §170 will be denied to any individual, partnership, or corporation that fails to meet specific appraisal and documentation requirements. An exception exists if the taxpayer fails to meet these requirements due to reasonable cause, and not because of willful intent.

For purposes of determining the threshold values for the various reporting requirements, all similar items of noncash property, whether donated to a single



donee or multiple donees, shall be aggregated and treated as a single property donation.

For property valued at more than \$500, the taxpayer (other than a personal service corporation or closely held C corporation) must include with his or her return a written description of the donated property for the tax year in which the contribution is made.

For property valued at more than \$5,000, the taxpayer must include whatever information about the property and about the qualified appraisal of that property that the IRS prescribes by regulations with his or her return for the tax year in which the contribution is made. If the contributions are valued at \$500,000 or more, then the qualified appraisal must be attached to the return when filed.

This amendment is applicable to contributions made after June 3, 2004.

Deduction for donation of patents and other intellectual property limited to basis –

The amount of a patent or other intellectual property (other than certain copyrights or inventory) contributed to a charitable organization is limited to the lesser of the taxpayer's basis in the property or the fair market value of the property. This limitation applies to contributions of patents, certain copyrights, trademarks, trade name, trade secret, know-how, certain software, or similar intellectual property or applications or registrations of such property.

This amendment is applicable to contributions made after June 3, 2004.

III. Business Provisions

Section 179 – The new law extends for two more years the increased §179 deduction, the expense deduction for off-the-shelf computer software, and the election to revoke the deduction on prior year's returns. Thus, for tax years beginning in 2003, 2004, 2005, 2006, and 2007, the dollar limitation is \$100,000 and the investment limitation is \$400,000. Both these amounts are indexed for inflation in years after 2003. In 2004, the §179 limit is \$102,000 and the investment limit is \$410,000. For tax years beginning in 2008, these limits return to the \$25,000 and \$200,000 levels, respectively.

SUVs – The new law limits the cost of a sport utility vehicle (SUV) that may be expensed under §179 to \$25,000. The new law does not eliminate the exemption from the luxury auto depreciation limits under §280F for SUVs or other vehicles



with a gross vehicle weight rating in excess of 6,000 pounds. For this purpose, an SUV is defined as a four-wheeled vehicle with a gross vehicle weight of more than 6,000 pounds, but less than 14,000 pounds.

Because this definition would include heavy pickup trucks, vans, and small buses in addition to SUVs, the term "sport utility vehicle" is further defined to exclude any of the following vehicles:

1. A vehicle designed to have a seating capacity of more than nine persons behind the driver's seat.
2. A vehicle equipped with a cargo area of at least six feet in interior length that is an open area and is not readily accessible directly from the passenger compartment.
3. A vehicle equipped with a cargo area of at least six feet in interior length that is designed for use as an open area but is enclosed by a cap and is not readily accessible directly from the passenger compartment.
4. A vehicle with an integral enclosure, fully enclosing the driver compartment and load carrying device, does not have seating rearward of the driver's seat, and has no body section protruding more than 30 inches ahead of the leading edge of the windshield.

This provision is effective for vehicles placed in service after the date of enactment.

Leasehold improvements – "Qualified leasehold improvement property" placed in service after October 22, 2004, and before January 1, 2006, is 15-year MACRS property with a 15-year recovery period. This provision is not elective. If the requirements for qualification are met, then the improvement must be depreciated over 15 years using the straight-line method. A taxpayer; however, could effectively avoid the provision by electing the alternative depreciation system (ADS) and depreciating the improvements over 39 years. However, the ADS election would also apply to any other MACRS 15-year property that the taxpayer happened to place in service in the same tax year.

Qualified leasehold improvement property is any improvement to an interior portion of *nonresidential real property* if the following requirements are satisfied:

1. The improvement is made under or pursuant to a lease by the lessee, any sublessee, or the lessor. A commitment to enter into a lease is treated as a lease for this purpose.
2. The lease is not between related persons.
3. The building (or portion that the improvement is made to) is occupied exclusively by the lessee or sublessee.

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4. The improvement is section 1250 property (i.e., a structural component).
5. The improvement is placed into service more than three years after the date that the building was first placed into service.

Depreciation period of qualified restaurant property – The new law assigns a 15-year MACRS recovery period to "qualified restaurant property" placed in service after the October 22, 2004, and before January 1, 2006. The straight-line method applies to such property. If the MACRS alternative depreciation system (ADS) is elected or otherwise applies, the applicable MACRS recovery period is 39 years and the straight-line method applies. Whether or not ADS is elected, the applicable convention is the half-year convention, unless the mid-quarter convention applies. The 15-year recovery period is not elective. However, a taxpayer could effectively elect out by making an ADS election. An ADS election, however, would apply to all MACRS 15-year property placed in service by the taxpayer during the tax year.

Qualified restaurant property is any §1250 property which is an improvement to a building if the improvement is placed in service more than three years after the date the building was first placed in service and more than 50 percent of the building's square footage is devoted to preparation of and seating for on-premises consumption of prepared meals.

Bonus depreciation on noncommercial aircraft – An aircraft that is *not* used in the trade or business of transporting persons or property (other than for agricultural or firefighting purposes) will qualify for bonus depreciation and the extended January 1, 2006, placed-in-service date, if the following requirements are met:

1. The original use of the aircraft commences with the taxpayer after September 10, 2001; and either;
 - o The aircraft was acquired by the taxpayer after September 10, 2001, and before January 1, 2005 and no written binding contract for the acquisition was in effect before September 11, 2001, or
 - o The aircraft was acquired pursuant to a written binding contract entered into after September 10, 2001, and before January 1, 2005.
2. The aircraft is purchased and the at the time of the contract for purchase, the purchaser made a nonrefundable deposit at least equal to 10 percent of the cost or \$100,000.
3. The aircraft has an estimated production period exceeding four months and a cost exceeding \$200,000.

Deduction for \$5,000 of start-up and organizational expenditures – Effective for amounts paid or incurred after October 22, 2004, the new law allows taxpayers to



elect to deduct up to \$5,000 of start-up expenditures in the tax year in which their trade or business begins. The \$5,000 amount must be reduced (but not below zero) by the amount by which the start-up expenditures exceed \$50,000. The remainder of any start-up expenditures, those that are not deductible in the year in which the trade or business begins, must be ratably amortized over the 180-month period (15 years) beginning with the month in which the active trade or business begins. Similarly, partnerships and corporations may elect to deduct up to \$5,000 of start-up and organizational expenditures for the tax year in which the partnership or corporation begins business. The \$5,000 amount must also be reduced by the amount by which the organizational expenditures exceed \$50,000. The corporation may deduct any remainder of organizational expenditures ratably over the 180-month period beginning with the month in which the corporation begins business.

Deduction limited for certain entertainment expenses – In the case of specified individuals, entertainment expenses for goods, services, or facilities are deductible only to the extent that the expenses do not exceed the amount of the expenses which are treated by the taxpayer, with respect to the recipient, as compensation paid to an employee and as wages subject to withholding. A deduction is also allowed for entertainment expenses paid or incurred by a taxpayer for an individual who is not an employee only to the extent the expenses do not exceed the amount includible in the gross income of the recipient of the entertainment, amusement, or recreation as compensation for services rendered, or as a prize or award.

A specified individual includes officers, directors, and 10-percent-or-greater owners of private and publicly held companies.

Allowance to immediately expense certain film or television costs – A taxpayer may elect to treat the cost of any "qualified" film or television production as a currently deductible expense which is not chargeable to a capital account. If the taxpayer elects, it may not depreciate or amortize any assets which are expensed. The election must be made by the due date (including extensions) for filing the taxpayer's tax return for the tax year in which costs of the production are first incurred. Once the election is made, the election may not be revoked without the IRS consent.

A production is a "qualified production" if 75 percent of the total compensation is qualified compensation and the production is property described in §168(f)(3) (prohibiting motion picture films and videotapes from ACRS). With respect to television series, only the first 44 episodes of such series may be taken into



account. Qualified compensation expenses are restricted to compensation paid for services performed in the United States by actors, directors, producers, and other relevant production personnel.

Employment taxes do not apply to qualified stock options – The *Act* changes the definition of wages for FICA tax purposes to exclude from wages remuneration on account of a transfer of a share of stock pursuant to an exercise of an Incentive Stock Option (ISO) or Employee Stock Purchase Plan (ESPP) option, or on account of a disposition of stock acquired through such an exercise. Similar changes are made with respect to Railroad Retirement Act and FUTA taxes.

Gains resulting from a disqualifying disposition of stock acquired through exercise of a qualified stock option or reportable under the 85/100-percent ESPP option rule are subject to income tax at ordinary rates. However, the 2004 Jobs Act makes it clear that the employer is not required to withhold income tax in the event of a disqualifying disposition of stock. Furthermore, withholding is not required with respect to amounts taxable under the 85/100-percent rule.

IV. Agriculture and Farming Issues

Special rules for livestock sold due to weather-related conditions –

The provision expands the events that may precipitate the involuntary conversion of livestock to include not only soil contamination or other environmental contamination but also drought, flood, or other weather-related conditions. The taxpayer can replace the involuntarily converted livestock with property similar or related in use to the livestock so converted, or if that is not feasible, to replace the converted property with other property used for farming purposes including real property. Real property will be considered replacement property only in the case of soil contamination or other environmental contamination.

The provision extends the replacement period during which the proceeds from involuntarily converted livestock under §1033(e) may be used to obtain replacement property that is similar or related in use without the recognition of gain. The provision extends from two years to four years the time period during which the taxpayer may purchase replacement property.

The provision applies to any tax year for which the due date (without regard to extensions) for the return is after December 31, 2002.



Farmers' and fishermen's income averaging and AMT – Commercial fishermen are now able to elect to use income averaging, just like farmers engaged in a farming activity. Furthermore, both fishermen and farmers may receive the full benefit of income averaging, even if they are otherwise subject to the alternative minimum tax (AMT). The coordination of farmers' and fishermen's income averaging and the change in AMT apply to tax years beginning after December 31, 2003.

Reforestation deduction increased; credit repealed – The new law provides that up to \$10,000 (\$5,000 for married taxpayers filing separately) in qualified reforestation expenditures may be currently deducted in the year paid or incurred. The amendment is effective for expenditures paid or incurred after October 22, 2004. Qualified reforestation expenditures in excess of this \$10,000 annual amount may be capitalized and amortized over 84 months.

Timber sales – Outright sales of standing timber after December 31, 2004, will qualify for capital gain treatment. The requirement that the owner of timber must retain an economic interest in the timber in order to obtain capital gain treatment does not apply to outright sales of timber. The provision is effective for sales of timber after December 31, 2004.

V. S Corporations

Shareholder limit increased from 75 to 100 – The maximum number of eligible S corporation shareholders is increased from 75 to 100. The provision is effective for tax years beginning after December 31, 2004.

Family members may be treated as one shareholder – For purposes of counting the number of shareholders to determine if the 100-shareholder limit is exceeded, all family members can elect to be treated as one shareholder. The term "members of the family" is defined as the common ancestor, the lineal descendants of the common ancestor, and the spouses (or former spouses) of the lineal descendants or common ancestor. Note that the common ancestor cannot be more than six generations removed from the youngest generation of shareholders at the time the S election is made (or October 22, 2004, if later). A spouse (or former spouse) will be treated as being of the same generation as the individual to which he or she is (or was) married.

Transfer of suspended losses to spouse or former spouse incident to divorce –



If a shareholder's stock is transferred to his or her spouse, or to a former spouse incident to divorce (as described in §1041), any suspended loss or deduction with respect to that stock will be treated as incurred by the S corporation in the succeeding tax year with respect to the transferee. The provision applies to tax years beginning after December 31, 2004.

Disposition of S corporation stock by QSST treated as disposition by the QSST beneficiary – The disposition of S corporation stock by a qualified subchapter S trust (QSST) is treated as a disposition of the stock by the QSST beneficiary for purposes of applying the passive activity loss and the at-risk limitations of §465 and §469(g). Therefore, the beneficiary of a qualified subchapter S trust is generally allowed to deduct suspended losses under the at-risk rules and the passive loss rules when the trust disposes of the S corporation stock. The provision is applicable to transfers made after December 31, 2004.

Banks can now elect S corporation status despite ownership of bank stock by IRAs – A bank with stock held in IRAs can make an S corporation election without first having to redeem those shares.