

American Jobs Creation Act of 2004

Congress passed another significant new tax law in October 2004 known as the "American Jobs Creation Act of 2004" (AJCA). Some of the new provisions will begin before the date of enactment, some after the date of enactment, while others take effect beginning in 2005.

Although mainly directed toward large businesses, particularly multinationals, the wide-ranging law has several provisions affecting individuals and small or closely held businesses.

On the plus side, the new law:

- Creates a new deduction, with potentially widespread applicability, for businesses having income "attributable to domestic production activities";
- Extends previously enacted increases in small business "expensing" allowance;
- Liberalizes the rules governing S-Corporations;

- Permits itemizers to deduct their state and local sales taxes in lieu of state and local income taxes (effective for tax years 2004 and 2005);
- Accelerates the depreciation period for leasehold and restaurant improvements from 39 years to 15 years.

On the minus side, the new law:

- Limits the "expensing" allowance for sport utility vehicles (SUVs) placed in service after the new law's enactment date to \$25,000;
- Starting January 1, 2005, imposes tighter rules on taxpayers who want to claim a deduction of more than \$500 for motor vehicles, boats, or airplanes donated to charity;
- Imposes tighter rules for documenting charitable contributions of property made after June 3, 2004;

- Dramatically toughens the rules for "nonqualified" deferred compensation plans, which are used by business owners and other executives as a supplement to, or in lieu of, the "qualified" retirement plans generally available to a business's employees.

Overview of the new law

The impetus for the new law was a 2002 World Trade Organization ruling that the U.S. tax code's "extraterritorial income exclusion" was a prohibited export subsidy. The law addresses that issue by repealing the exclusion with generous transitional rules and creating the new deduction mentioned above.

In addition, however, lawmakers used the new law as a vehicle for a variety of legislative initiatives that had been pending for, in certain cases, several years. Some of these could be called "special interest legislation," but many enjoyed broad support and will have a broad impact.

Dozens of provisions affect individuals and small or closely held businesses. Although day-to-day experience in working with the new law will undoubtedly reveal some implications that are not apparent at this point, we believe the provisions mentioned at the beginning of this letter are the most significant for the great majority of our clients.

Small business "expensing" increases extended

Previous legislation increased the annual allowance for taxable years beginning after 2002 and before 2006 to \$100,000 (from \$25,000) and the "phase-out" threshold to \$400,000 (from \$200,000), with annual inflation adjustments, and added off-the-shelf software as eligible property. For taxable years beginning after 2005, the dollar amount was scheduled to revert back to \$25,000. The new law extends the increased annual allowance through taxable years beginning before 2008.

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The Working Families Tax Relief Act of 2004

For the fourth time in four years Congress has enacted some big tax cuts. How much you'll save in taxes depends on your filing status, family circumstances and business situation, and how you maximize benefits through careful planning. The following information will help you identify which parts of the new \$146 billion tax cut package can

benefit you. It also explains how timely tax planning can enhance these benefits.

The new law provides tax relief to individuals and to businesses. Businesses especially should note that the title of the new law, "The Working Families Tax Relief Act of 2004," is misleading. The new law is

not only about relief to families. As Congress often does, it started with a tax bill to increase just one tax provision – the child tax credit – and used the same bill to tack on many more tax cuts for a broad spectrum of taxpayers, from single filers to small businesses to global corporations. The new law makes over 175 changes to the Tax Code.

Overview

The new law extends two sets of expiring provisions: one for individuals and one for businesses. Without these extensions, individual taxpayers would be paying a lot more in taxes in 2005 and subsequent years than in 2004. Business taxpayers receive even more immediate tax relief. The business tax breaks,

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S-Corporation rules liberalized

Several new rules make it easier to qualify as an S-Corporation or to retain that status. Among other things, the new law:

- Treats certain family members as one shareholder for purposes of the limit on the number of eligible shareholders;
- Increases the number of eligible shareholders to 100;
- Provides relief from inadvertently invalid qualified subchapter S subsidiary (QSST) elections.

SUV expensing allowance limited to \$25,000

Previously, SUVs weighing more than 6,000 pounds were not subject to the limitations imposed on so-called “luxury” automobiles because their weight put them outside the limitation triggering definition of “passenger” automobiles. The new law creates a separate category for such SUVs (including those rated at a gross vehicle weight of not more than 14,000 pounds) and imposes a \$25,000 limit on the deduction. This limit will be effective for property placed in service after the date of enactment.

Itemized deduction for state and local sales taxes

Individuals who itemize their deductions can now elect to deduct state and local sales taxes instead of state and local income taxes. Although the principal beneficiaries are residents of states that do not have an income tax, the new deduction provides an alternative for taxpayers living in states that impose both income and sales taxes. The amount of the deduction can be based on actual taxes paid or by using IRS-prepared tables. This provision is retroactive to January 1, 2004.

Charitable deduction rules tightened

Obtaining a deduction for the charitable contribution of your car, or a boat or airplane, will be more dif-

ficult after December 31, 2004. After that date, you may no longer use the “Blue Book” value because your deduction is limited to the amount for which the charity later sells the vehicle. In addition to this limitation on the amount of your deduction, the charity must prepare, and you must attach to your return, a statement identifying the vehicle and stating the amount for which it was sold. Failure to attach the statement will result in disallowance of your deduction.

Finally, the new law strengthens the requirements for substantiating contributions of property (excluding contributions of cash or publicly traded stock) made after June 3, 2004. The new law codifies existing IRS rules that require that: (1) certain information be provided on the return if the deduction exceeds \$500; and (2) the taxpayer obtains a qualified appraisal for property with a value exceeding \$5,000. There is also a new requirement that the appraisal be attached to the tax return when the deduction exceeds \$500,000.

Nonqualified deferred compensation rules toughened

The new law significantly changes the law of nonqualified deferred compensation and imposes potentially large tax penalties for non-compliance. Unless a nonqualified deferred compensation (NQDC) plan meets the requirements of a new Tax Code section, amounts deferred under the plan are includible in income back to the time of deferral or, if later, when no longer subject to a substantial risk of forfeiture, and are subject to interest at the underpayment rate plus 1% and a 20% additional tax.

The new law imposes requirements of NQDC plans with regard to participant elections, distributions, acceleration and funding that likely will necessitate amendments to most NQDC plans. A participant must make an election to defer compensation by the end of the taxable

year preceding the year in which the employee will perform services for the company. Employees who are newly eligible must elect to defer within 30 days of becoming eligible. For performance-based compensation for services provided over a period of at least 12 months, the election must be made no later than six months before the end of the service period. The plan or the election must include the timing and form of a distribution.

Except as provided by regulations yet to be issued, distributions are permitted only upon the following triggers: (1) separation from service; (2) death of the participant; (3) a specified time or pursuant to a fixed schedule (but not upon a specified event); (4) change in control of the corporation; (5) an unforeseeable emergency; or (6) disability of the participant. Also except as provided by regulations, a plan may not accelerate a distribution. This provision negates such commonly used approaches as “haircuts,” which permit a participant to take a distribution at any time, but the participant must forfeit a portion of his or her account balance over the amount of the distribution.

The new law provisions apply to amounts deferred after December 31, 2004.

Deduction from qualified production activities income

This deduction replaces the “extra-territorial income exclusion,” which the new law repealed in response to the World Trade Organization ruling that the exclusion was a prohibited export subsidy. Although created because of an international trade dispute, the new deduction could be broadly applicable.

When fully phased in, the deduction could be as much as 9% of “qualified production activities income,” which, in essence, is the net income attributable to “domestic production gross receipts.” The latter term encompasses much more than

income from U.S. based manufacturing activities. In addition to traditional manufacturers, any business might qualify if it:

- Produces, grows, or extracts;
- “In whole or in significant part within the United States;”
- Any tangible personal property, computer software, or sound recordings;
- Derives income from any “lease, rental, license, sale, exchange, or other disposition of” such property.

Other qualifying activities include:

- Performing construction in the United States;
- Performing engineering or architectural services in the United States for construction projects in the United States;
- Producing electricity, natural gas, or portable water in the United States;
- Producing films for which at least 50% of the total compensation paid was for services in the United States.

Taxpayers eligible for the deduction include individuals and pass-through entities such as S-Corporations, partnerships, and limited liability companies (LLCs), as well as C-Corporations.

More than 10% of small businesses will be affected by this provision, according to official estimates, and the Conference Committee report anticipates the need for “extensive additional regulatory guidance.” With the new rule set to go into effect in taxable years beginning after December 31, 2004, such guidance presumably will be high on the government’s priority list. ■

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which have been extended into 2005 by the new law, had already expired for the most part at the end of 2003.

Tax relief for individuals

Here are the big changes for most individual taxpayers:

- Parents of children under 17 can continue to claim a \$1,000 child tax credit for every child through 2010. Without the new law, the child credit would have plummeted to \$700 per child in 2005.
- Married taxpayers filing jointly will continue to benefit from full marriage penalty relief. Through 2010, joint filers pay tax at double the single rate for the 15 percent rate and for the standard deduction. For 2005, this means having the high end of the 15 percent tax bracket pegged at \$59,400 (rather than at \$53,450) if Congress hadn't passed the new law. The change in the new law in the standard deduction for married

couples filing jointly is equally as dramatic, \$10,000 in 2005 instead of \$8,700.

- The alternative minimum tax (AMT) exemption amount remains at \$42,250 for single individuals and \$58,000 for married couples for one more year. Taxpayers can also use the personal nonrefundable credits against AMT liability for one more year.

Tax relief for businesses

The new law extends over 20 tax breaks for business taxpayers back to January 1, 2004 and forward to December 31, 2005. These tax breaks benefit almost every business. Some of the more popular extensions apply to the research credit; work opportunity tax credit; welfare-to-work tax credit; charitable contributions of computer technology and equipment used for educational purposes; classroom expenses of school teachers;

expensing of environmental remediation costs; credit for qualified clean-fuel vehicle property; and Archer Medical Savings Accounts.

Consequences

The tax planning implications of the new law for individuals are as broad as the scope of the law itself. For example, individuals going through a divorce know that the right to claim the child tax credit is very valuable. For married couples who both work, and whose incomes are about equal, marriage penalty relief in the new law comes as a welcome perk for 2005. However, year-end strategies for accelerating or deferring income and doing the opposite for deductions remain critical for many couples since the marriage penalty is not eliminated in any of the tax brackets above the 15 percent bracket.

Finally, on the individual tax planning side, the tax breaks in the new

law require most people to take a very close look at the AMT. You may be liable for AMT because the new law could reduce your regular tax liability and at the same time increase your liability for AMT.

Businesses have an easier time implementing to the new law. For each of the extended credits or deductions, businesses should evaluate if they qualify for any of the extended credits or deductions, such as the work opportunity credit, and then take steps to make sure they qualify in 2004, 2005 or in both years.

Whatever your circumstances, you'll likely benefit from taking time to do some tax planning as the result of the new law. Please don't hesitate to call our office for more details about the new law and your personal income or business situation. ■

Social Security Benefits

Understanding the basics of how social security works is sometimes very complicated, but understanding it is very important to any person planning to retire. The current Social Security system works like this: when you work, you and your employer pay taxes (6.20% each up to \$87,900 of income earned in 2004) into Social Security. The tax money is used to pay benefits to people who already have retired, people who are disabled, survivors of workers who have died, and dependents of beneficiaries. The money you pay in taxes is not held in a personal account for you to use when you get benefits. Your taxes are being used right now to pay people who now are getting benefits. Any unused money goes to the Social Security trust funds, not a personal account with your name on it.

You become eligible for Social Security as you work and pay taxes; you earn Social Security "credits." In 2004, you earn one credit for each \$900 in earnings up to a maximum of four credits per year. The amount of money

needed to earn one credit goes up every year. Most people need 40 credits (10 years of work) to qualify for benefits. Younger people need fewer credits to be eligible for disability benefits or for family members to be eligible for survivors' benefits when the worker dies.

Social Security benefits replace a percentage of your earnings when you retire, become disabled or die. Each year, you will receive a Social Security Statement showing your earnings history and an estimate of the retirement, disability and survivors benefits you and your family may receive based on those earnings. You should check your earnings history carefully and make sure all of your earnings are accurate. Be sure to report errors to the Social Security Administration.

The full retirement age has been gradually increasing since 2003. Although the full retirement age is rising, you should still apply for Medicare benefits within three months of your 65th birthday. If you wait longer, your

Medicare medical insurance may cost you more money. The following chart will guide you in determining your full retirement age:

FULL RETIREMENT AGE	
Year of birth	Full retirement age
1937 or earlier	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943-1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960	67

Your retirement benefit is calculated based on your 35 highest earnings years. Your wages are adjusted for inflation and the result is your "average indexed monthly earnings." When your average monthly earnings are determined another calculation is done. You will receive 90% of the first \$612, then 32% of the next \$3,077 and then 15% of the remainder.

See the following benefit computation example:

If your average monthly earnings are = \$3,750
then your benefit would be = \$1,543

Average Monthly Earnings: \$3,750

90% of First	\$ 612 = \$ 550
32 % of the Next	\$ 3,077 = \$ 984
15% of the Remainder	\$ 61 = \$ 9
	<hr/>
	\$ 3,750 \$ 1,543

You may retire as early as the age of 62. However, if you start your benefits early, your benefits are reduced permanently. Your benefit is reduced about one half of one percent for each month you start your Social Security before your full retirement age. For example, if your full retirement age is 65 and 6 months and you sign up for Social Security when you are 62, you would only get 77.5 percent of your full benefit.

As you can see, Social Security is and will be an important factor when you consider retirement. ■

Client Profile:

We are pleased to feature the **Disabled American Veterans, Department of Maryland, Inc.** and are proud of our long association with this fine organization.

The **Disabled American Veterans, Department of Maryland, Inc.** has a long tradition of providing various services to veterans of all the major wars and conflicts involving American forces. These services and assistance to veterans and their families have been facilitated by the coordinated efforts of the Department

Commander and his staff, the local community chapter of the DAV, the professional trained national service officer corp. along with individual chapter service officers and through many directives and other communication from the National DAV staff.



The Department of Maryland is once again in the position, under the leadership of Commander Wilbert Forbes (pictured left), of returning to its full glory years at being one of the most outstanding Departments in the national organization. His enthusiasm regarding

increasing memberships for the local charities, providing transportation needs for veterans to get access to counseling for appropriate benefits is apparent in all his written communications and staff meetings.

The hospital programs are not forgotten because of an ongoing hospital rehabilitation funded program. Other donations are made to the DAV programs to assist in purchasing pharmaceuticals, patient identification boards, television sets for the rehab center and to the holiday gift programs for hospitalized veterans and many other patient programs. ■

Tax Due Date Calendar

JANUARY 18

Final installment of 2004 estimated tax by individuals, trusts and estates due.

JANUARY 31

Last day to receive W-2 and 1099 information statements from your employer, bank, broker, etc..

Fourth quarter 2004 payroll tax returns due.

Annual federal unemployment returns due.

Individuals who owed, but did not pay, estimated tax on January 18th can file a final 2004 income tax return and pay the

tax in full to avoid late payment penalty.

FEBRUARY 15

Last day for filing Form W-4 by employees who wish to claim exemption from withholding of income tax for 2005.

FEBRUARY 28

Annual 1099 series returns and Form 1096 or Form 4804 must be filed with the IRS to report payments to recipients who received Form 1099 on January 31st, as indicated above.

Form W-2 "A" copies for 2004, along with W-3 to be filed with the Social Security Administration.

Form W-2G and Form 1099-R for 2004 "A" copies, along with 1096 or Form 4804, to be filed with IRS.

MARCH 15

Corporate income tax returns for calendar year 2004 due.

Last day for filing an application (Form 7004) by calendar-year corporations for automatic six-month extension to file 2004 income tax returns.

APRIL 15

Individual tax returns (or extension request) and final payment of tax are due for 2004.

First quarter individual estimated tax payments due for 2005.

Gift tax returns and payment of gift tax for 2004 due.

Last day for making your 2004 IRA contribution.

Partnership returns for 2004 due.

Fiduciary income tax returns for calendar year 2004 due.

MAY 2

First quarter 2005 payroll tax returns due.

BG&H NEWS

We are pleased to welcome **John T. Watkins, Jr., CPA** to our accounting and auditing department. John is a graduate of Ben Franklin University and his experience includes public accounting as well as auditing with the Department of the Army. John and his wife Margaret have 4 sons, 3 grandchildren and make their home in Bowie.

We would also like to welcome **M. Vivienne Tran, CPA** to our tax department. She received her Bachelors Degree at the University of Maryland and is currently pursuing her Masters Degree. Vivienne has experience in public and private accounting and resides in Laurel.

The following awards were recently presented at our annual firm retreat:

Bormel, Grice & Huyett Award of Excellence – **Catherine Newman**

Thumbs Up Award – **Ray Plummer**

Certificate of Appreciation – **Donna Kibler**

Brenda L.L. Cummings, CPA has passed the required exams for the designation of Certified Specialist in Estate Planning (CSEP). Congratulations to **Brenda L.L. Cummings, CPA, CSEP**.

Donna L. Peirce was recently presented an award for 10 years of outstanding service and appreciation from Bormel, Grice & Huyett, P.A.

Thank you to the entire staff for supporting the Susan G. Komen Breast Cancer Foundation for the 4th year in a row. The firm raised funds for the Foundation during Lee National Denim Day in October. Our appreciation to **Barbara Bormel** for organizing this event.

BG&H held its annual company picnic in June. **Martina Megofna** and **Marie Bradshaw** organized a silent auction to benefit the Bormel, Grice & Huyett Business Scholarship Fund. We raised over \$1,200 toward the scholarship fund. Thank you to our staff and firm friends who helped make this event a success.

Bormel, Grice & Huyett, PA sponsored a 2004 basketball team through the Howard County Recreation and Parks. The Bormel, Grice & Huyett team members included **Ray Plummer, Brian Jordan, David Young** and **Larry Bormel**. Other participants included Mike Taylor, Mike Cornelius, Jeff Papcun, Phil Foss, Garrett Dick and Paul O'Connor. Our thanks to the team's coach, Ray Plummer. Photos of the team in action can be found at our web-site at www.bormel-grice.com.

Anna E.R. Huyett, CPA was re-elected as Treasurer for the PTA at St. Johns Lane Elementary School.

Larry P. Bormel, CPA was re-elected as President of the Laurel Regional Hospital Foundation.

Catherine Newman, CPA recently participated in a focus group for accountants who are users of financial software. The focus group was organized by Intuit, the maker of QuickBooks, Quicken, and TurboTax and facilitated by Shugoll Research, a national market research firm.

If you haven't already done so, please visit our website at www.bormel-grice.com. Through our website you can access information about our firm and its specialty groups, the latest issue of our newsletter, and links to other sites such as tax forms and publications, Maryland Comptroller of the Treasury, Maryland Association of Certified Public Accountants, American Institute of Certified Public Accountants, Baltimore-Washington Corridor Chamber, State Department of Assessments and Taxation, Bloomberg Financial Services, and client websites. Your comments and feedback are welcome and appreciated.

The BG&H UPDATE is published for our clients, staff, and professional contacts. Copies will be provided to other business people upon written request. Any action based on information contained herein should be taken only after a detailed review of the specific situation.

The following members of our firm have contributed to this edition: **Larry Bormel, Anna Huyett, Catherine Newman, Mike Myers, Marlene Collins, Donna Peirce, Ray Plummer and Bette Anne Sanders**.