



PETRINOVICH PUGH & COMPANY, LLP
Certified Public Accountants & Consultants

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Dear Client:

Passed by Congress earlier this month and signed by President Bush late last week, the **American Jobs Creation Act of 2004** provides tax relief to manufacturers, small businesses and S corporations, among others. But it also contains many provisions that will increase tax liability for both businesses and individuals.

Originally slated to be a simple repeal of the foreign sales corporation/extraterritorial income (FSC/ETI) tax regime, the act does indeed phase out FSC/ETI benefits by 2007. But it ended up as a 650-page behemoth whose myriad provisions are scheduled to go into effect at various times. While analysts are still determining exactly what impact they will have, here's a brief look at the provisions most likely to affect you.

BUSINESSES

- **New manufacturing deduction created.** The somewhat complicated deduction for "qualified production activities income" will apply to both C corporations and flow-through business entities. When fully phased in by 2010, the maximum possible 9% deduction will effectively reduce the top income tax rate for manufacturing businesses from 35% to roughly 32%. The phase-in will begin in 2005 with a 3% deduction that will yield approximately a 1% tax savings. "Manufacturer" is defined broadly to include such companies as construction, architectural and engineering, oil and gas, and film and music.
- **\$100,000 Section 179 expensing deduction extended through 2007.** This amount also will continue to be indexed for inflation, as will the \$400,000 asset acquisition limit for qualifying for the maximum deduction. The 2004 amounts are \$102,000 and \$410,000, respectively.
- **SUV deduction reduced.** The maximum expense deduction for SUVs weighing between 6,000 and 14,000 pounds goes down to \$25,000, effective the day after the date of enactment. SUVs weighing more than 6,000 pounds placed in service before then can qualify for the full Section 179 maximum.
- **S corporation rules reformed.** Important changes include expanding the maximum number of shareholders to 100 (from 75) and allowing family members to be considered one shareholder, effective for tax years beginning after Dec. 31, 2004.
- **Nonqualified deferred compensation plan rules tightened.** The changes affect deferral elections, distribution restrictions, accelerated payment restrictions and taxability of certain transfers of property. They apply to deferrals made after Dec. 31, 2004. Many plans may need to make changes in their agreements and how they operate.

INDIVIDUALS

- **New state sales tax deduction created.** For 2004 and 2005, individuals can choose to deduct state and local sales taxes paid instead of state and local income taxes. This may be particularly beneficial for residents of states that don't levy income taxes, but other taxpayers can also benefit if their sales tax liability exceeds their state and local income tax liability. In states with income tax rates that are

relatively low, the benefit may occur if you make a large purchase such as an automobile.

- **Certain charitable deductions limited.** If a charity sells a donated vehicle, the donor can deduct only the amount of the actual sale proceeds. If the charity keeps and uses the vehicle, the donor can deduct only the amount the charity acknowledges as its value, with steep penalties imposed for misrepresenting the value. This provision goes into effect for donations made after Dec. 31, 2004. The deduction for donations of intellectual property (including patents and most copyrights) also will be limited, beginning with contributions made after June 3, 2004.

Petrinovich Pugh & Company, LLP specializes in helping individuals and businesses minimize their taxes and maximize their financial well-being. Our advisors would welcome any questions you have about these or the other provisions of this act and how they may affect you. Please send a reply e-mail to info@ppandco.com or call us at 408-287-7911 and let us know how we can be of assistance.

Best regards,

Petrinovich Pugh & Company, LLP