Summary of the New American Jobs Creation Act of 2004

Background

On 10/11/04, the American Jobs Creation Act of 2004--which we will refer to as the 2004 Jobs Act--was passed by the Senate after clearing the House at neck-breaking speed the previous week. Despite some misgivings, President Bush says he will sign the bill (HR 4520) and may have done so by the time you read this.

Unlike the recently enacted Working Families Tax Relief Act of 2004 (which the president signed into law on 10/4/04), the 2004 Jobs Act is a massive piece of legislation with over 600 fun-filled pages. There are literally hundreds of changes. Many of them are quite arcane and will not affect garden-variety clients. However, a good number of the changes will affect many clients.

Our mission in this *National Tax Advisory* is necessarily limited to acquainting you with what we think are the most important provisions. In future issues, we will follow up with more detailed analysis as we pick apart the new law and come to grips with all the implications for you and your clients.

As you know, the excuse for the 2004 Jobs Act was to repeal existing federal income tax breaks for foreign sale corporations (FSCs) and extraterritorial income (ETI). This was necessary because the World Trade Organization had ruled that the FSC/ETI regime amounted to an illegal export subsidy. To compensate for repealing the FSC/ETI breaks, the new law delivers billions of dollars worth of business tax benefits plus a bunch of other taxpayer-friendly changes that have absolutely nothing to do with foreign trade. In other words, this legislation morphed into the predictable grab bag of goodies that you often see passed right before a general election. The cost of the goodies is around $140 billion--chump change by Washington's standards.

Unlike the last few tax laws, the 2004 Jobs Act is allegedly revenue-neutral. In other words, it includes bad news as well as good news for taxpayers. Beyond the revenue raised from repealing the FSC/ETI regime, the new law will purportedly break even by shutting down various perceived loopholes, strengthening tax penalties, and continuing IRS user-fee programs.

With those general thoughts in mind, we are now ready to get more specific. Here goes.

Business Tax Changes

Repeal of FSC/ETI Regime

Starting after this year, the new law phases out the FSC/ETI regime of tax breaks for international transactions. Taxpayers will be able to claim 100% of their FSC/ETI tax benefits for 2004, 80% for 2005, and 60% for 2006, with complete repeal after that. In general, full benefits will still be available for binding contracts that were in effect as of 9/17/03.

New Deduction for Domestic Producers

To offset the loss of tax benefits under the FSC/ETI regime, the new law delivers a 9% deduction for domestic producers. The write-off is phased in over several years as follows: 3% for tax years beginning in 2005 and 2006, 6% for years beginning in 2007-2009, and the full 9% for years beginning in 2010 and beyond.

When fully phased in, the deduction is intended to be equivalent to a 3% federal income tax rate reduction for qualifying domestic production activities--assuming the taxpayer is in the maximum 35% federal rate bracket. Importantly, the new deduction is not limited to C corporations. It's also available to S corporations, partnerships, sole proprietorships, cooperatives, estates, and trusts and the deduction is not limited to taxpayers that export to foreign countries. In fact, it's potentially available to many businesses that will be completely unaffected by the repeal of the FSC/ETI regime. Finally, the deduction is allowed for both regular tax and AMT purposes.

The deduction equals the applicable percentage (3% for 2005 and 2006) of the lesser of: (1) qualified production activities income for the year or (2) taxable income for the year. However, the deduction can't exceed 50% of wages for the year. The definition of *qualified production activities* is very broad. Many taxpayers will qualify for the write-off, including (but not limited to) those engaged in the following industries:

- o Traditional manufacturing of tangible personal property.
- o Construction in the U.S.
- o Civil engineering and architectural services for U.S. construction projects.
- o Production of electricity, gas, and potable water.
- o Software production.
- o Film and videotape production, renting, and licensing.
- o Growing of agricultural products and food (also known as farming).
- o Processing of agricultural products and food (coffee roasting counts as a qualified production activity, but brewing up your triple venti latte at the local Starbucks doesn't).

Observation: Because the potential application of the new deduction is so broad, tax commentators and practitioners will be dissecting the rules for a good long while. Expect the government to make issuing regulations on this subject a very high priority.

Major Overhaul of Rules for Foreign Activities

The new law makes big changes in the tax rules for businesses with income from foreign activities. For example, the foreign tax credit (FTC) rules are liberalized. The limitation on the FTC to no more than 90% of the taxpayer's AMT is eliminated. A temporary 85% dividends received deduction for U.S. corporations is intended to encourage companies to bring home cash accumulated in controlled foreign corporations. The new law also includes a host of other provisions that can be important for taxpayers with foreign earnings.

Depreciation Changes

Extension of Liberalized Section 179 Deduction Rules. The new law extends the current maximum Section 179 deduction ($100,000 indexed for inflation) for an additional two years--through tax years beginning before 2008. For tax years beginning in 2008 and beyond, the maximum deduction is scheduled to fall back to only $25,000. For tax years beginning before 2008, the new law also extends the other favorable Section 179 changes made by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (e.g., the ability to claim the deduction for off-the-shelf software costs, the $400,000 inflation-adjusted threshold for the deduction phaseout rule, and so on). These taxpayer-friendly rules were scheduled to vanish for tax years beginning in 2006 and beyond.

Reduced Section 179 Deduction for SUVs (Affects 2004 Returns). The new law places a $25,000 limit on the Section 179 deduction for "heavy" SUVs with gross vehicle weight ratings of 14,000 pounds or less. Before this change, SUVs with gross vehicle weight ratings of more than 6,000 pounds could qualify for the full $100,000 maximum deduction ($102,000 for 2004). This unfavorable new rule affects SUVs placed in service after the date of enactment (the date the president signs the bill). However, it won't apply to any vehicle that: (1) is designed to seat more than nine passengers behind the driver's seat (e.g., a hotel shuttle van); (2) has an open cargo area or covered box not readily accessible from the passenger compartment of at least six feet in length (e.g., many pickups with full-size cargo beds); or (3) has an integral enclosure that fully encloses the driver compartment and load carrying device, does not have seating behind the driver's seat, and has no body section protruding more than 30 inches ahead of the leading edge of the windshield (e.g., a delivery van). Vehicles that fall under these exceptions still qualify for the full Section 179 allowance ($102,000 for 2004), as long as they have gross vehicle weight ratings in excess of 6,000 pounds. Exceptions are also provided for ambulances, hearses, and vehicles used directly in the trade or business of transporting passengers or property for compensation or hire.

Year-end Planning Alert: Despite the unfavorable new SUV rule, the idea of buying a new heavy SUV to be used over 50% for business before the end of

2004 still makes great sense--even if the placed in service date is after the date of enactment. The combination of 50% first-year bonus depreciation and regular first-year MACRS depreciation will allow taxpayers to immediately deduct much of the depreciable cost in excess of the new $25,000 Section 179 cap. However, time is of the essence here, because the first-year bonus depreciation break expires after 12/31/04. **Remember:** First-year bonus depreciation is only available for new (not used) vehicles.

15-year Depreciation Recovery Period for Leasehold Improvements (Affects 2004 Returns). Under current law, nonresidential leasehold improvements are generally required to be depreciated straight-line over 39 years. This typically extends well beyond the useful life of such improvements. To correct this, the new law establishes a statutory 15-year recovery period for qualified nonresidential leasehold improvement property placed in service before 2006. The straight-line method continues to apply.

Qualified leasehold improvement property is generally defined in the same way as under the first-year bonus depreciation rules. This change is effective for property placed in service after the date of enactment and before 2006.

Year-end Planning Alert: The first-year bonus depreciation break expires after 12/31/04.

15-year Depreciation Recovery Period for Restaurant Improvements (Affects 2004 Returns). As with leasehold improvements, current law generally requires restaurant improvements to be depreciated over 39 years--a period well beyond the actual life of such improvements given their heavy commercial use. Therefore, the new law provides a statutory 15-year recovery period for qualified restaurant property placed in service before 2006. The straight-line method must be used.

Qualified restaurant property means any improvement to a building if such improvement is placed in service more than three years after the date such building was first placed in service and more than 50% of the building's square footage is devoted to the preparation of, and seating for, on-premises consumption of prepared meals. Note that qualified restaurant property placed in service before the end of 2004 is now eligible for first-year bonus depreciation by virtue of the new 15-year recovery period rule. This change is effective for property placed in service after the date of enactment and before 2006.

Year-end Planning Alert: Immediate action is required to fully benefit from this change because the first-year bonus depreciation break expires after 12/31/04.

Extended Bonus Depreciation for Certain Noncommercial Aircraft. The new law allows certain non-commercial aircraft placed in service before 2006 to qualify for first-year bonus depreciation.

S Corporation Changes

Number of Shareholders. The new law allows family members to elect to be treated as one shareholder for purposes of determining the number of shareholders of an S corporation. Even better, the new law increases the maximum allowable number of S corporation shareholders from the current 75 to 100. These changes are effective for tax years beginning after 2004.

Electing Small Business Trusts (ESBTs). The new law disregards unexercised powers of appointment in determining who are the potential current beneficiaries of an electing small business trust (ESBT). The new law also increases the period during which an ESBT can dispose of stock (to avoid becoming an ineligible shareholder) after an ineligible person becomes a potential current beneficiary of the trust. The disposition period is extended from 60 days to one year. These changes are effective for tax years beginning after 2004.

Qualified Subchapter S Trusts (QSSTs). In general, the new law allows the beneficiary of a qualified subchapter S trust (QSST) to deduct the QSST's share of S corporation losses that were suspended under the at-risk rules or passive loss rules when the QSST disposes of the related S corporation stock. This change is effective for tax years beginning after 2004.

Suspended Losses after Divorce. The new law allows S corporation losses that were suspended due to basis limitations to be transferred (along with the related shares of S corporation stock) to a spouse or former spouse in divorce. This change is effective for transfers after 2004.

Relief for QSUB Procedural Foul-ups. The new law allows the IRS to waive inadvertent errors by taxpayers attempting to make or terminate elections for qualified subchapter S subsidiaries (QSUBs). This change is effective for elections and terminations occurring after 2004.

Information Returns for QSUBs. The new law allows the IRS to provide guidance regarding the filing of information returns by qualified subchapter S subsidiaries (QSUBs). Currently, no returns are required. This change is effective for tax years beginning 2004.

Distributions to Pay ESOP Loans. The new law permits distributions paid on S corporation stock owned by the corporation's ESOP to be used to pay ESOP stock acquisition loans without violating applicable tax rules, provided certain requirements are met. This change applies retroactively to S corporation stock distributions paid after 1997.

IRAs Can Own S Corp. Bank Stock. The new law allows an IRA (including a Roth IRA) to hold the stock of an S corporation bank, provided the stock was held by the IRA on the date of enactment. The new law also allows an IRA to sell such stock to the IRA beneficiary (account owner) without violating the prohibited transaction rules if: (1) the sale is pursuant to an S corporation election by the bank; (2) the sale is for fair market value on terms at least as favorable to the IRA as the terms would be for a sale to an unrelated party; (3) the IRA incurs no commissions, costs, or other expenses in connection with the sale; and (4) the stock is sold in a single transaction for cash not later than 120 days after the S corporation election is made.

Passive Investment Income Test for S Corp. Banks. The new law provides that a bank (as defined in IRC Sec. 581), bank holding company [as defined in section 2(a) of the Bank Holding Company Act of 1956],
or financial holding company [as defined in section 2(p) of that Act] need not treat interest income and dividends paid on assets required to be held by the bank or holding company as passive investment income for purposes of the S corporation passive investment income rules. This change is effective for tax years beginning after 2004.

New Rules for Start-up and Organizational Expenditures (Affects 2004 Returns)

Under current law, taxpayers can elect to amortize start-up expenditures over 60 months (under IRC Sec. 195). Taxpayers can also elect to amortize corporate and partnership organizational expenditures over 60 months (under IRC Secs. 248 and 708 respectively). Under the new law, taxpayers can elect to deduct up to $5,000 of start-up and up to $5,000 of organizational expenditures in the tax year in which the trade or business begins. However, each $5,000 allowance is reduced by the amount of cumulative start-up or organizational expenditures in excess of $50,000 (the $50,000 threshold applies separately to each category of expenditures). Startup and organizational expenditures that are not deductible in the year in which the trade or business begins must be capitalized and amortized over 15 years on a straight-line basis (the same treatment as for Section 197 intangibles).

This change is effective for expenditures incurred after the date of enactment. Taxpayers can still elect to amortize start-up and organizational expenditures incurred on or before the date of enactment over 60 months. However, all start-up and organizational expenditures related to a particular trade or business (whether incurred before or after the date of enactment) will be counted in determining whether the cumulative expenditures exceed $50,000 (i.e., pre-enactment expenditures can potentially impact the treatment of post-enactment expenditures).

No Federal Payroll Taxes on Exercise of Statutory Stock Options Or on Dispositions of Related Stock

Incentive stock options (ISOs) and options under an employee stock purchase plan (ESP) are referred to as statutory options. The IRS announced in Notice 2002-47 that until further guidance was issued, it would not attempt to assess FICA or FUTA taxes or require federal income tax withholding upon either: (1)

the exercise of a statutory stock option or (2) the disposition of stock acquired by exercising a statutory stock option (including a disqualifying disposition).

The new law codifies and makes permanent this favorable treatment and clarifies that federal income tax withholding is not required on a disqualifying disposition or when taxable compensation is recognized due to an employee stock purchase plan discount. Similar rules apply under the Railroad Retirement Tax Act. These changes are effective for stock acquired pursuant to options exercised after the date of enactment. Current-law tax reporting requirements continue to apply.

Reduced Deductions for Bigwigs' Entertainment and Recreation Expenses (Affects 2004 Returns)

Under the new law, businesses can only deduct the amount reported as taxable compensation to "covered employees." This rule applies to expenses for: (1) activities generally considered to be entertainment, amusement, or recreation and (2) facilities used in connection with such activities (e.g., company airplanes). For example, a company's deduction for aircraft operating costs to fly a covered employee to his or her vacation destination on a company aircraft is limited to the amount reported to the employee as taxable compensation. In any case, the amount of the deduction cannot exceed the actual cost (but if the actual cost exceeds the amount reported as compensation, only the compensation amount can be deducted).

Covered employees are defined as individuals subject to the requirements of section 16(a) of the Securities and Exchange Act of 1934 or who would be subject to such requirements if the employer or service recipient were an issuer of equity securities referred to in section 16(a). Such individuals generally include officers, directors, and 10%-or-greater owners of private and publicly held companies. With respect to covered employees, this change is intended to overturn the pro-taxpayer result in *Sutherland Lumber-Southwest, Inc*. The change is effective for expenses incurred after the date of enactment.

Tax Breaks for Agriculture, Fishing, and Timber (Affects 2004 Returns)

Beyond to the new 9% deduction for qualified domestic production activities, the 2004 Jobs Act includes a host of new tax breaks for the agriculture, timber, and fishing industries. These include the following (among many others):

- o Coordination of the farm income averaging rules with the AMT rules to prevent the use of averaging from increasing the taxpayer's exposure to the AMT. This change is retroactively effective for tax years beginning after 2003. Therefore, calendar-year 2004 returns are affected.
- o Extension of income averaging (previously available only to farmers) to fishermen. This change is retroactively effective for tax years beginning after 2003. Therefore, calendar-year 2004 returns are affected.

- o The replacement period to defer involuntary conversion gains from certain forced early sales of livestock due to drought, flood, or other weather-related conditions is extended from two to four years. Also, the new law liberalizes the rules regarding what qualifies as similar replacement property. These changes are retroactively effective for tax years for which the unextended return due date is after 12/31/02. Therefore, 2004 returns are affected. Also, some 2002 and 2003 returns may need to be amended.

- o In presidentially declared disaster areas, affected cash-basis taxpayers now have up to four years after the end of the disaster event year to elect a one-year deferral of income from early forced sales of livestock [IRC Sec. 451(e)]. This change is retroactively effective for tax years for which the unextended return due date is after 12/31/02. Therefore, 2004 returns are affected. Also, some 2002 and 2003 returns may need to be amended.

- o Capital gains treatment is allowed for outright sales of timber by landowners after 2004.

Individual Tax Changes

New Deduction for State and Local Sales Taxes (Affects 2004 Returns)

The new law allows individual taxpayers to elect to claim an itemized deduction for either general state and local sales taxes or state income taxes (if any), but not both. This change is intended to put those who live in jurisdictions with low or no personal income taxes on an equal footing with those who are able to deduct state and local income taxes. Under the new rule, taxpayers can choose to deduct their actual sales tax amounts or instead deduct predetermined amounts from IRS tables (plus actual amounts for purchases of motor vehicles, boats, and certain other items to be specified by the IRS in future guidance). The change is effective for tax years beginning in 2004 and 2005 only, unless Congress acts to extend it.

Year-end Planning Alert: As is the case with the deduction for state and local income taxes, the new sales tax deduction is disallowed for AMT purposes. Rats!

Above-the-line Deduction for Attorney Fees Incurred in Discrimination Suits (Affects 2004 Returns)

As you know, some courts have opined that current federal income tax law requires individuals to:
(1) include 100% of certain legal judgments and settlements in taxable gross income and (2) treat the related contingent attorney fees and costs as miscellaneous itemized deductions. Under this view, a claimant who wins a judgment or settlement can effectively be forced to pay federal income tax on

most or all of the attorney's contingent fee and related costs--even though these amounts are subtracted from the judgment or settlement received by the claimant. This obviously unfair result is caused by limitations on miscellaneous itemized deductions under the regular tax rules and the outright disallowance of miscellaneous itemized deductions under the AMT rules.

The new law takes a step in the right direction by providing a new above-the-line deduction for attorney fees and costs paid by or on behalf of a claimant in legal actions involving claims of unlawful discrimination, certain claims against the federal government, and private causes of action under the Medicare Secondary Payer statute. The new law includes a long laundry list of actions that count as unlawful discrimination actions (including violations of the Civil Rights Acts of 1964 and 1991, the Congressional Accountability Act of 1995, the National Labor Relations Act, the Family and Medical Leave Act of 1993, the Fair Housing Act, the Americans with Disabilities Act of 1990, various whistle blower statutes, and so on).

This change applies to fees and costs paid after the date of enactment with respect to any judgment or settlement occurring after that date.

Observation: The new rule effectively allows an eligible taxpayer to subtract contingent attorney fees and related costs from the amount of the judgment or settlement on page 1 of Form 1040. Gosh, that makes perfect sense! Thank you, Congress! Now, let's extend the concept to all taxable judgments and settlements.

New Limit on Home-sale Gain Exclusion for Residences Acquired in Like-kind Exchanges (Affects 2004 Returns)

Under the new law, individuals cannot claim the IRC Section 121 home-sale gain exclusion for residences that were acquired in tax-deferred Section 1031 like-kind exchanges within the prior five years. This change applies to sales or exchanges of principal residences after the date of enactment.

Favorable Capital Gains Rates Apply to Certain Disqualifying Dispositions of Stock Acquired by Exercising Statutory Options (Affects 2004 Returns)

Incentive stock options (ISOs) and stock options offered under an employee stock purchase plan (ESP) are referred to as statutory options. If an employee sells stock acquired by exercising a statutory option after holding the stock for the required period, the gain is taxed at favorable capital gains rates. However, gains from disqualifying (premature) dispositions are taxed at ordinary rates.

The new law provides that when an eligible person is required to sell stock acquired by exercising a statutory option to comply with federal conflict of interest requirements, he or she is treated as satisfying the statutory holding period requirements--regardless of how long the stock was actually held. An eligible person generally includes an officer or employee of the executive branch of the federal government (and any spouse or minor or dependent children whose ownership is attributable to the officer or employee). The employer that granted the statutory option is not allowed a deduction upon such a sale by an eligible person.

This change is effective for sales after the date of enactment.

Tougher Rules for Deferred Compensation Arrangements

The new law includes a batch of complicated rules intended to make it more difficult for individuals to enter into deferred compensation arrangements with their employers. In a nutshell, the new rules generally require deferred compensation elections to be made before the beginning of the tax year in which the deferred compensation will be earned. However, elections to defer performance-based compensation can be made as late as six months before the performance period ends. New restrictions are imposed on when deferred compensation payouts can be received and on subsequent elections to change the form of payment or delay payments. The new rules are effective for amounts deferred under nonqualified deferred compensation arrangements in tax years beginning after 2004.

Observation: The new rules will require significant planning and compliance efforts. This may become fertile ground for interested tax practitioners.

New Provisions for Noncash Charitable Contributions

Stricter Rules for Donated Vehicles (and Boats and Planes)

Under the new law, allowable deductions for charitable contributions of vehicles, boats, and airplanes (collectively referred to as "assets" in this explanation) for which the claimed value exceeds $500 will depend on how the donated asset is used by the recipient charity. If the organization sells the asset without any significant intervening use or material improvement, the donor's deduction is limited to the gross sales proceeds received by the charity. The actual fair market value of the donated asset is irrelevant.

The new law also imposes very strict substantiation requirements for contributions of vehicles, boats, and planes when the claimed value exceeds $500. Under these rules, no deduction is allowed unless the donor receives a contemporaneous written acknowledgment from the charity. That document must include the name and taxpayer identification number of the donor and the vehicle identification number (or similar number) of the asset. In addition, if the charity sells the asset without significant intervening use or material improvement, the acknowledgment must: (1) certify that the asset was sold in an arm's length transaction between unrelated parties, (2) certify the amount of the gross sales proceeds, and (3) include a warning that the donor's deduction is limited to the amount of the sales proceeds.

In the rarer cases where charities intend to make significant use of donated assets or make material improvements, the required acknowledgment must certify: (1) the intended use and duration of such use or the intended material improvements to be made and (2) that the asset will not be transferred in exchange for money, other property, or services before completion of such use or improvements.

To be considered contemporaneous, the acknowledgment must be provided to the donor within 30 days of the date of the sale of the asset (assuming the asset is not significantly used or materially improved). In all other cases, the acknowledgment must be provided within 30 days of the contribution.

A charity can be charged a penalty if it knowingly furnishes a false or fraudulent acknowledgment or if it knowingly fails to furnish an acknowledgment that meets all the new requirements. The penalty can be as high as $5,000.

To the extent required by the IRS, charities must disclose to the IRS information included in acknowledgments given to donors.

The IRS is expected to issue regulations that exempt sales of assets that are considered to be in direct furtherance of the organization's charitable purposes from the rule that the donor's deduction is limited to the gross proceeds from sale. For example, say an organization directly furthers its charitable purposes by selling donated cars to needy persons at prices significantly below fair market value. In this circumstance, the exemption would apply. If so, the donor could deduct the asset's fair market value even if that amount exceeded the gross proceeds from the charity's sale of the asset. (It's hard to see how this exemption could ever apply to boats or planes.)

These changes are effective for contributions made after 2004.

Observation: Wow! Talk about overkill! Congress must think overstated deductions for charitable donations of vehicles, boats, and planes are responsible for the entire federal budget deficit as well as the decline and impending fall of Western civilization. Obviously, charities have their work cut out for them if they intend to continue accepting donations of these assets.

> **Example:** In early 2005, Joe Taxpayer makes a charitable contribution of a used car (in good running condition with no need for immediate repairs) to a charity that runs an elder care facility. The charity accepts the vehicle and immediately provides Joe with a proper written acknowledgment. The document includes Joe's name and social security number, the car's vehicle identification number (VIN), a certification that the charity intends to use the car for at least a year to transport the facility's residents to events and to deliver meals to the needy, and a certification that the car won't be transferred in exchange for money, other property, or services before completion of said use by

> the charity. A few days after receiving the car, the organization begins using it three times a week to transport residents to various community events, and twice a week to deliver food to the needy. The charity continues to regularly use the car for these purposes for approximately one year. Then, the car is sold.
>
> Under these facts, the charity's use of the car constitutes significant intervening use prior to the sale. Therefore, Joe's deduction is not limited to the gross sales proceeds received by the organization. Instead, Joe can deduct the full fair market value of the car at the time of the donation (same as under current law).

Year-end Planning Alert: Clients who are considering making charitable donations of vehicles, boats, or planes should be advised to get it done before the end of this year. That way, they can deduct the asset's full fair market value, and the recipient charitable organization will only have to comply with current-law substantiation requirements (a piece of cake compared to dealing with the rules that will take effect next year).

Retroactively Tighter Rules for Other Noncash Donations (Affects 2004 Returns)

Under the new law, stricter donor reporting is required for certain contributions of property other than cash, inventory, or publicly traded securities. All C corporations are required to obtain a qualified appraisal for donated property if the claimed deduction exceeds $5,000. (This rule has long applied to individuals.) If the claimed deduction for a donation of property other than cash, inventory, or publicly traded securities exceeds $500,000, a qualified appraisal must be attached to the donor's tax return. This new requirement applies whether the donor is an individual, partnership, or corporation.

For purposes of the dollar thresholds, all similar items of property donated to one or more charitable organizations are aggregated and treated as one item. If the donor fails to properly substantiate a noncash charitable contribution, the deduction is denied. If the donor is a partnership or S corporation, the deduction is denied at the partner or shareholder level. However, the deduction is not denied if failure to meet the substantiation rules is due to reasonable cause and not willful neglect. Appraisals are not required for charitable contributions of vehicles, boats, and planes if the charity sells the asset without significant intervening use or material improvement and provides the donor with an acknowledgment that satisfies the rules for such donations (see the preceding item).

These changes are effective for contributions made after 6/3/04.

Retroactive New Rules for Donations of Patents (Affects 2004 Returns)

The new law provides that if a taxpayer contributes a patent or other intellectual property (other than certain copyrights or inventory) to charity, the taxpayer's initial deduction is limited to the lesser of:
(1) the taxpayer's basis in the property or (2) fair market value. The taxpayer is permitted to deduct certain additional amounts in later years, based on a specified percentage of qualified income received or accrued by the charitable organization from the contributed property. These additional amounts are calculated using sliding-scale percentages that decline over the years. No deduction is permitted for any revenues or income received or accrued by the charity after the expiration of the legal life of the patent or intellectual property.

Donors must inform the charity at the time of the contribution that they intend to treat the contribution as one that is subject to the rules allowing additional charitable deductions. They must also obtain written substantiation from the charity of the amount of any qualified donee income from the contributed property during the charity's tax year. In turn, the charity must file an annual information return reporting the qualified donee income and other required information.

Under these rules, additional charitable deductions are not available for patents or other intellectual property contributed to a private foundation [other than a private operating foundation or certain other private foundations described in IRC Sec. 170(b)(1)(E)].

This change is effective for contributions made after 6/3/04.

Other Revenue Raisers

The new law includes various and sundry revenue-raising and loophole-closing provisions beyond the ones covered in this release. These include (but are not limited to) the following:

- o Provisions intended to reduce tax avoidance accomplished via corporate inversions and individual expatriation.

- o Rules designed to shut down abusive tax shelters by creating a new penalty for failure to disclose reportable transactions, strengthening the accuracy-related penalty, weakening client confidentiality privileges, lengthening the limitations period for failing to disclose listed transactions, and various other measures.

- o New rules intended to combating fuel tax evasion.

- o Extension of the IRS user-fee program through September 30, 2014.