CCH Tax Briefing:

WORKING FAMILIES TAX RELIEF ACT OF 2004

Special Report

September 23, 2004

2004 Tax Extenders Bill Stats

- *Number of Tax Code Changes 175*
- *Expiring Business Provisions 23*
- *Child Credit Price Tag .... $61.5 billion*
- *10% Bracket Relief .... $29 billion*
- *Extended AMT Relief ..... $22.5 billion*
- *Marriage Penalty Relief ..... $15.6 billion*
- *Individual Extensions Now Set Through 2010*
- *Expiring Business Provision Now Set Through 2005*

Inside

Congress Spends $146 Billion To Extend Individual And Business Tax Cuts; Adds New Tax Relief

The Working Families Tax Relief Act of 2004 (H.R. 1308), a $146 billion tax cut bill for both individuals and businesses, is headed to the White House. After undergoing some compromise in Conference, the bill sailed through the House on September 23 by a comfortable 339 to 65 margin, and was accepted by the Senate 92-3 the same day. The bill now moves to the President's desk for his expected signature.

The new law's heavy lifting primarily takes place in extending two sets of expiring provisions:

(1) Four accelerated tax cuts from the 2001 and 2003 tax acts scheduled to expire on December 31, 2004, and

(2) A package of regularly expiring business tax provisions that, for the most part, had expired on December 31, 2003.

Several new provisions are also included – among them a new uniform definition of a child to be used throughout the Tax Code and an expansion of the definition of earned income to include combat pay for purposes of the refundable child tax credit and earned income credit. "Technical Corrections," over 30 making substantive changes, round out the 150-plus page Conference Report and Agreement.

WHAT IT MEANS

"Without this agreement, the marriage penalty will creep back into the Tax Code, the child tax credit will drop from $1,000 to just $700, the 10-percent bracket will be applied to less income, and the alternative minimum tax (AMT) will affect more middle-income families," House Ways and Means Chairman Bill Thomas, R-Calif., declared after the Conference announced the details of the final bill. Despite some grumbling from fiscal hawks in the House and Senate about the lack of offsets in the bill, lawmakers approved the package.

> ***Caution.*** Although the new law has "Working Families" in its title, it provides tax benefits to many more taxpayers beyond the family unit … including single individuals and businesses. In addition, while the new law is also being commonly referred to as the "extenders package," several provisions are not related to extensions. H.R. 1308 also contains an important "Technical Corrections" title, which true to past "technical corrections," makes certain substantive changes.

Without these extensions, withholding and estimated tax payments for most taxpayers starting in 2005 would have been noticeably higher. Many businesses would also come up short because some important tax credits would no longer be available. Taxpayers already in the process of year-end tax planning should scuttle plans to accelerate income into 2004 and defer deductions into 2005 to avoid what would have been a tax increase in 2005.

Continued on page 2

Comment The new law can be viewed two ways. The provisions amount to a $132 billion tax cut for individuals and a $14 billion tax cut for businesses. Or, they block an automatic tax increase of those amounts. It took the impending election-year recess to persuade Congress not to alienate voters with the automatic tax increase. After failing to pass a bill to everyone's liking earlier this year, lawmakers compromised. The extensions are more temporary than some had hoped for (especially for those who want to make the "Bush tax cuts" permanent) and are likely to increase the federal budget deficit higher than many lawmakers wanted to go.

TAX CUTS FOR INDIVIDUALS

Extensions of the $1,000 child tax credit, the full elimination of the marriage penalty in the standard deduction and the 15-percent tax bracket, and the full increase in the size of the 10-percent tax bracket result in these provisions continuing seamlessly at their enhanced levels through 2010.

Impact These amounts equal the fully phased-in benefits called for in the *Economic Growth and Tax Relief Reconciliation Act of 2001* (EGTRRA). Those amounts had been accelerated into 2003 and 2004 by the *Jobs and Growth Tax Relief Reconciliation Act of 2003* (JGTRRA). The new law now accelerates them to extend beyond 2004 as needed to meet the particular year in which the same benefit is fully phased in under EGTRRA.

Caution. Most EGTRRA benefits automatically sunset at the end of 2010.

List of accelerated benefits. The new law extends the following accelerated individual tax breaks:

- **$1,000-per-child tax credit, now effective through 2010.**

Impact This credit has been on a roller coaster ride since 2001. EGTRRA gradually increased the credit between 2001 and 2010, when it would reach $1,000. Congress then accelerated the $1,000 credit amount for 2003 and 2004 in JGTRRA. If Congress hadn't extended the higher amount in this new law, it would have fallen back to $700 in 2005. Now, it will remain at $1,000 until EGTRRA itself sunsets at the end of 2010. Unfortunately, this amount is not indexed annually for inflation.

- **The expanded 10-percent tax bracket, now effective through 2010.**

Impact EGTRRA had set these amounts at $12,000 and $6,000 until after 2007, when they would rise to the $14,000 and $7,000 levels through 2010. JGTRRA accelerated the $14,000 and $7,000 amounts for 2003 and 2004 only, and included indexing after 2003. The new law continues the $14,000 and $7,000 levels through 2010 and indexes them for inflation. Heads of households retain $10,000 as their 10% bracket end point.

- **Marriage penalty relief in the 15-percent tax bracket, now effective through 2010.**

Impact EGTRRA had scheduled a phased-in increase in the top end of the 15-percent tax bracket for married taxpayers filing jointly over a three-year period beginning in 2005, reaching double that of single filers for 2008 through 2010. JGTRRA accelerated EGTRRA's fully phased-in benefit for 2003 and 2004 and the new law finishes the job by extending the same accelerated benefit to meet EGTRRA's timetable.

- **Full marriage penalty relief in the standard deduction, now effective through 2010.**

Impact This provision accelerates benefits for 2005 though 2008. The EGTRRA fully phased-in marriage penalty benefit (double the amount of the standard deduction given to single taxpayers) starts in 2009. That benefit had been accelerated by JGTRRA for 2003 and 2004 only.

- **Extending higher alternative minimum tax exemptions through 2005.**

Impact The new law gives Congress one more year to start addressing the problem of millions of taxpayers eventually paying AMT. EGTRRA had increased the exemption amounts to $49,000 for married individuals filing a joint return and surviving spouses, and $35,750 for single taxpayers. JGTRRA raised the exemptions to $58,000 and $40,250 but only for 2003 and 2004. Now, AMT taxpayers can enjoy the higher exemption amounts for one more year.

There's much more! Despite being known as the "extenders bill," not all provisions are extensions. Special tax relief aimed at low-income families and military families was added to the bill as urgent, "must pass" provisions.

These include:

- **Child credit.** Acceleration to 2004 of the increase from 10-percent to 15-percent refundability of the child credit for low-income families.
- **Definition of child.** Simplification by providing a uniform definition of a child throughout the Tax Code, starting in 2005. The new law creates a common definition of child for the dependency exemption, child credit, earned income tax credit, dependent care credit, and head of household filing status.
- **Combat pay.** Including combat pay in earned income for purposes of computing the refundable portion of the child tax credit. Allowing individuals to elect to treat combat pay as earned income for purposes of the earned income credit.

- **Nonrefundable personal credits.** The provision allowing nonrefundable personal tax credits to the full extent of regular and alternative minimum tax liability is extended to tax years beginning in 2004 and 2005.

TAX RELIEF FOR BUSINESSES

Businesses, large and small, also benefit from the new law, receiving $14 billion in tax breaks through 2005. These business incentives were not expected to be included in the final bill. At the last minute, some of the business extenders that had been in the floundering ETI/FSC bill were moved into the extenders package as a more reliable vehicle for passage. Business extenders are different from individual extenders, however, in that most of them have already expired.

Caution. The new law generally extends these provisions retroactively to when they expired.

The business extenders include:

- **The research and development tax credit** is extended for amounts paid or incurred after June 30, 2004 and before 2006.

Impact Over $4.3 billion in R&D credits are claimed each year by some of America's biggest companies. They had been hoping for an expansion of the research tax credit, but came away with only an extension.

- **The welfare-to-work and work opportunity tax credits** are extended for wages paid or incurred for qualified individuals starting work after 2003 and before 2006.

Impact Many businesses have been lobbying for extensions of these two credits, which reward employers for hiring economically disadvantaged individuals. The WOTC can reach as high as $2,400 for each employee. The maximum welfare-to-work credit is $8,500 per employee. On September 10, more than 2,000 companies wrote to President Bush reminding him that they had hired qualified workers in 2004 based on the expectation that these credits would be extended.

- **The enhanced deduction for charitable contributions of qualified computers** is extended for contributions made in tax years beginning after 2003 and before 2006.

Impact To encourage corporate donations of computers and related equipment, Congress has extended a special tax break. The enhanced incentive, which allows a deduction in excess of basis, is available for some corporations. Donations generally must be made to libraries and schools.

- **Expensing of environmental remediation costs.** This treatment is extended for expenses paid or incurred after 2003 and before 2006.
- **The renewable-source energy credit** is extended for facilities placed in service after 2003 and before 2006.
- **Suspension of the marginal-well net-income limitation** is extended for tax years beginning after 2003 and before 2006.
- **Indian employment tax credit** is extended to tax years beginning before January 1, 2006.
- **Accelerated depreciation for business property on Native American reservations** is extended to property placed in service before January 1, 2006.

Other important incentives include:

- **Teacher's classroom expense deduction** is extended for 2004 and 2005.

Impact The National Education Association in Washington, D.C. reports that the "average teacher spends about $450 of his or her own money each year on books and supplies. Eighty percent report spending $1,000 or more." This incentive allows professional educators to deduct, above-the-line, up to $250 of out-of-pocket classroom expenses. The deduction is available to K-12 teachers, instructors, counselors, principals, and aides. The deduction had expired at the beginning of this year. The new law extends it for 2004 and 2005.

- **Repeal of the credit phase-out for qualified electric and clean fuel vehicles** for property acquired in 2004 and 2005.
- **Contributions to Archer Medical Savings Accounts** (MSAs) are extended through 2004 and 2005.

Impact Archer MSAs have not fulfilled the initial vision of many lawmakers. Participation has lagged and now they have a new competitor: Health Savings Accounts (HSAs). Dan Perrin, Executive Director of the HSA Coalition in Washington, D.C. told CCH Tax & Accounting that HSAs are "supplanting MSAs in the marketplace. Ninety-nine percent of the time, consumers are converting to HSAs." Perrin predicted that this trend would continue unabated in 2005. MSA balances may be rolled over into HSAs.

- **Liberty Zone** incentives are extended through 2009 (to help taxpayers in New York City devastated by the 9-11 terrorist attacks).
- **Qualified Zone Academy Bonds** receive special treatment through 2005.
- **Cover over** of rum excise taxes to Puerto Rico and the U.S. Virgin Islands is extended at $13.25 per proof gallon through December 31, 2005.
- **Tax incentives for investment in the District of Columbia** are extended through December 31, 2005. This extension includes the special zero percent capital gains rate and the D.C. first-time homebuyer's credit.

Comment The new law also authorizes the IRS to continue to share tax and return information with other federal agencies, states and law enforcement, especially to combat ter-

Comparison of Impact of New Law on 2005 Taxes

Married Filing Jointly Tax Brackets

2005 with New Law: 2005 Taxable Income	Tax Rate	2005 without New Law: 2005 Taxable Income	Tax Rate
$0-$14,600	10%	$0-$12,000	10%
$14,601-$59,400	15%	$12,001-$53,450	15%
$59,401-$119,950	25%	$53,451-$119,950	25%
$119,951-$182,800	28%	$119,951-$182,800	28%
$182,801-$326,450	33%	$182,801-326,450	33%
Over $326,450	35%	Over $326,450	35%

Standard Deduction	
Married Filing Jointly	
2005 with new law:	$10,000
2005 without new law:	$8,700
Married Filing Separately	
2005 with new law:	$5,000
2005 without new law:	$4,350
10-Percent Bracket Level	
2005 with new law:	$14,600 or $7,300
2005 without new law:	$12,000 or $6,000
Child Tax Credit	
2005 with new law:	$1,000 per qualifying child
2005 without new law:	$700 per qualifying child
Alternative Minimum Tax	
2005 with new law:	$58,000 or $40,250 AMT exemption
2005 without new law:	$45,000 or $33,750 AMT exemption

rorism. Congress also authorized continuation of parity in application of certain mental health benefits.

WINNERS AND LOSERS

First, there are no losers in this tax bill … for now. All provisions give away tax dollars that otherwise had been scheduled to be collected …more than $132 billion worth over the next five years. The bill contains no revenue offsets.

Impact No revenue raisers were included, even in the form of provisions to collect more from tax shelter participants – almost everyone's bad guy lately. However, many economists forecast that the cost of the cuts will be paid by the public in one way or another through less spending for social services and/or increased taxes later, in another form. Others counter that the economic prosperity triggered by these cuts will pay for them.

Winning Individuals

Individuals who file joint returns and have children under age 17 benefit the most. They get the advantages of marriage penalty relief, the lower 10-percent bracket, the $1,000 child credit and, if applicable, the higher AMT exemption.

Next, all married taxpayers, whether filing jointly or not, benefit as long as their income puts them above the 10-percent bracket. They can use marriage penalty relief for the 15-percent bracket. Any married taxpayer can benefit from the increased standard deduction, whether or not he or she files jointly. The higher AMT exemption is also available.

Individuals, married and unmarried, benefit from extension of the higher child credit. All individuals also benefit from the increase in the end point for the 15-percent tax bracket.

Teachers benefit from the extension of the above-the-line deduction for classroom expenses.

Military families benefit from having combat pay used to figure income for purposes of qualifying for the earned income and child tax credits.

Example: A married couple filing jointly with total taxable income of $100,000 will pay $145 less in income taxes in 2005 than in 2004 due to indexing. However, if Congress had not extended the current tax provisions, the amount of their income taxed at 10 percent had been scheduled to shrink from $14,300 to $12,000, and the top of their 15-percent bracket had been scheduled to step down from $58,100 to $53,450, leaving more of their income taxable in the 25-percent bracket. The net effect for the joint filers with taxable income of $100,000 would have been a tax increase of $580. Add two children to this example, and the couple would have paid another $600 or $1,180 more tax in 2005 than in 2004.

Winning Businesses

Any business that can take advantage of any of the following items in 2005 benefits from the new law:

- The research and development tax credit.
- The welfare-to-work and work opportunity tax credits.
- The deduction for contributions of computers.
- Environmental remediation cost expensing.
- The renewable-source energy credit.
- Suspension of the marginal-well net-income limit.
- The credit for qualified electric and clean fuel vehicles.
- Liberty Zone activities.
- Indian employment credit.
- Accelerated depreciation on Native American reservations.

Tax shelter investors. The IRS is pursuing abusive tax shelters with a vengeance. It has loudly complained to Congress that it needs stiffer penalties to back up current anti-abuse rules. However, a package of such penalties, which would have been revenue raisers, was rejected as being inappropriate for this bill.

MORE EXPIRING PROVISIONS NEED ATTENTION SOON

Among those "extenders" that didn't make the cut to be included in the new law are three major items:

- Efforts have begun already to make the 15% and 5% capital gains tax rates permanent. The rates are scheduled to go back up to 20% and 10% starting in 2009. Starting in 2009, also, dividend income will no longer receive the preferential capital gains rate.
- Extension of the increase in the section 179 expensing limits also needs to be addressed soon. After 2005, the $100,000 limit (indexed for inflation) is scheduled to revert to the pre-2003 $25,000 level. Since this provision benefits small business, an extension is likely to be passed next year.
- Finally, bonus depreciation expires this year, and may not be extended. The Bush Administration maintains that bonus depreciation was intended only as a short-term stimulus after 9-11 and that it has done its job.

TECHNICAL CORRECTIONS

The new law devotes a separate title to "Technical Corrections", covering 15 major issues. The Conference reported that these corrections have no revenue effect because they reflect the intent of current law. However, some of them do have a substantive impact.

Health savings accounts: Amounts distributed from HSAs are not counted in determining the amount of health coverage tax credit an individual is eligible to receive.

Dividends rate. The new law clarifies that the extraordinary dividend rule applies to trusts and estates as well as individuals. It also provides clarification of 2002-2003 transition rules.

Stock holding period. The new law permits taxpayers to satisfy the stock holding period requirements when they acquire stock on the day before the ex-dividend date.

Bonus depreciation. Bonus depreciation property includes property subject to the section 263A capitalization rules by reason of having a long useful life.

Five-year NOL carryback. Only NOLs arising in tax years ending in 2001 and 2002 qualify for the five-year NOL carryback period.

Coverdell education savings accounts. The new law corrects changes to coordinate the rules for Coverdell accounts with the Hope and Lifetime Learning credits and qualified tuition programs.

AMT capital gain. The new law provides that the maximum amount of adjusted net capital gain eligible for the 5-percent rate under AMT is the excess of the maximum amount of taxable income that may be taxed at a rate of less than 25 percent under the regular tax, over the taxable income reduced by the adjusted net capital gain.

Count on CCH to provide you with practical and timely resources to help you understand and apply the changes enacted in the Working Families Tax Relief Act of 2004.

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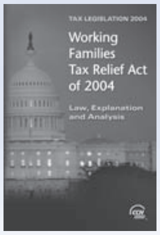

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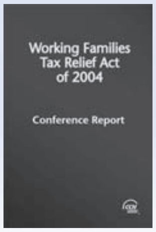

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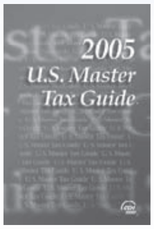

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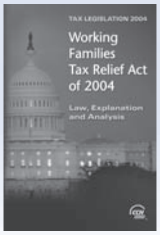

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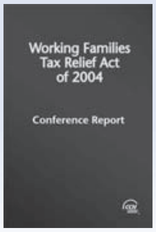

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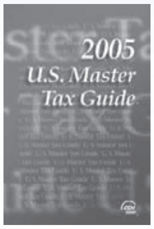

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