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The American Jobs Creation Act of 2004

Significant Tax Cut Legislation

On October 22, 2004, President Bush signed his fifth significant piece of tax-cut legislation, the American Jobs Creation Act of 2004 (P.L. 108-357). There are several important provisions for the construction industry in the Act, including:

- A new special deduction originally intended to focus on the export and manufacturing industries, but which now includes construction activities;
- Increased and newly accelerated depreciation opportunities that provide incentives for increased construction services; and
- Several business provisions that impact contractors.

The New Deduction

In exchange for repealing significant tax benefits for exporters, Congress is implementing a 9% (when fully phased-in) deduction for certain "qualified production activities." Available to corporate and most pass-through entities, the new deduction will be based on a complicated computation of "qualified production activities income" (QPAI).

"Domestic production gross receipts" is part of QPAI and includes: **1)** "construction performed in the United States or," **2)** "engineering or architectural services performed in the United States for construction projects in the United States." [P.L. 108-357 §199(c)(4)(A)(ii) and (iii)]

Note that "construction activities" are directly related to the erection or substantial renovation of residential or commercial buildings and infrastructure. Substantial renovations include structural improvements – but not cosmetic changes, such as painting. The calculation of this deduction has significant limitations and adjustments that determine which portion of these activities' gross receipts will be considered.

Generally, the new deduction is calculated by applying a phased-in percentage to the lesser of QPAI or taxable income. The rate to calculate the deduction is scheduled to phase-in as: 3% for 2005-2006, 6% for 2007-2009, and 9% after 2009.

The implication is that, in many cases, contractors will benefit from the new deduction and be able to reduce taxable income. In exchange for this, contractors may be faced with ancillary concerns such as an increased compliance burden. (For interim guidance, see IRS Notice 2005-14.)

New Depreciation Provisions

Once again, *depreciation is the GOP's golden carrot* to entice businesses to purchase certain assets and begin construction activities that might otherwise be delayed. This latest Act provides several new provisions, extends expensing thresholds, and also addresses several perceived abuses.

15-Year Recovery Period

A new 15-year recovery period will apply to certain leasehold improvements placed in service after October 22, 2004 and before 2006. This is a significant reduction from the 39-year period that would otherwise apply. The new rules cover interior improvements to nonresidential property provided:

- The improvement is made under a lease either by the lessee (or sublessee), or by the lessor, of that portion of the building to be occupied exclusively by the lessee (or sublessee);
- The improvement is placed in service more than three years after the date the building was first placed in service; and
- The improvement is not attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.

  Generally, if a lessor makes a qualified leasehold improvement, a subsequent owner cannot claim it as qualified leasehold improvement property. Fifteen-year straight-line depreciation will be used instead of the 15-year MACRS (150% declining balance) method. The bonus depreciation regulations will apply to defined qualified leasehold improvements.

Qualified Restaurant Property

The restaurant industry secured a 15-year recovery period for "qualified restaurant property" placed in service after

October 22, 2004 and before 2006. For contractors specializing in restaurants, this provision may boost business.

Qualified restaurant property is defined as any improvement to a building:

- If the improvement is placed in service more than three years after the 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-premise consumption of prepared meals.

Property/restaurant owners who take advantage of this recovery period must use the straight-line depreciation method.

Racetrack Improvements

Not to be outdone by the restaurant industry, a new provision assigns a MACRS recovery period of seven years to motorsport racetrack complexes (which include land improvements and support facilities, but not transportation equipment, warehouses, administrative buildings, hotels, or motels). The provision is effective for property placed in service after October 22, 2004 and before 2008.

Section 179

The §179 expensing threshold of $100,000 (adjusted for inflation) was scheduled to revert to $25,000 in 2005, but is now extended through 2007.

However, only $25,000 of the cost of a heavy SUV may be expensed under §179, effective for vehicles placed in service after October 22, 2004. Heavy SUVs – those with a gross vehicle weight rating (GVWR) of more than 6,000 pounds – are generally not subject to the "luxury auto" depreciation dollar caps and lease income inclusion amount rules.

Under the rules that applied before the Act, the entire cost of a heavy SUV used 100% for business could be expensed. Now, Congress has limited the deduction to $25,000.

Other Provisions

The Act has several provisions for businesses that should benefit contractors. For example, S corporations can now have up to 100 members, and all family members can elect to be treated as one member for the 100-member threshold. Other items of note include vehicle provisions and a general sales tax deduction.

Vehicle Provisions

Heavy & Highway contractors may wish to scrutinize a provision exempting mobile machinery from federal highway taxes. These changes should mean that mobile cranes, concrete pumpers, and certain paving equipment will not be taxable.

The new law codifies the current three-part design test effective for machinery that is: **1)** permanently attached to a chassis, **2)** designed to operate off-highway, and **3)** reaches jobsites over public roads under its own power.

The Act retains the full exemption from the 12% federal excise tax on new vehicles and the heavy vehicle use tax for equipment that meets the three-part test. The fuel tax will still apply, but a refund can be obtained at year-end if the equipment travels less than 7,500 miles on public roads during the year. Tires designed exclusively for off-road equipment will be exempt from the federal tire tax.

General Sales Tax Deduction

Effective for 2004 and 2005, taxpayers may elect to take an itemized deduction for state and local general sales tax in lieu of the present-law deduction for state and local income taxes.

Taxpayers can either accumulate receipts or reference a table (see www.irs.gov/pub/irs-pdf/p600.pdf) to determine their sales tax paid. In addition to the table amount, they can also deduct eligible sales taxes paid for vehicles, boats, and certain specified items. This is an added benefit for residents of the 10 or so states that have no income taxes. Taxpayers in other states must decide if they want to deduct the income or sales tax paid during the year.

Conclusion

The American Jobs Creation Act of 2004 is a very broad and complex piece of legislation, with intricacies beyond this brief overview. To benefit from the Act, contractors need to contact a tax advisor to determine how the new law will affect their business. BP

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Rich has presented comments before the IRS on proposed regulations and has testified before the House and Senate on the business impact of proposed legislation.

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