



## TAX ALERT

### Tax Break for Manufacturing, Construction, Engineering and Architectural Companies

The centerpiece of the recently enacted American Jobs Creation Act of 2004 was a new deduction for production activities conducted in the United States. The Act repeals the extraterritorial income (ETI) exclusion, which gave an exclusion for income attributable to export sales. The Act replaces ETI with a new tax deduction for domestic production activities and is effective for transactions after December 31, 2004.

***New deduction for U.S. production activities.*** The deduction is a percentage of the net income from those activities – 3% in 2005-2006, 6% for 2007-2009, and 9% after 2009. When fully phased in, the deduction is designed to be economically equivalent to a 3% reduction in the tax rate on U.S.-based production activities.

***Limitations on deductions.*** The amount of the deduction for any tax year has two limitations:

- It may not exceed 50% of the employer's W-2 wages for that tax year and
- It is further limited to taxable income (or adjusted gross income in the case of an individual taxpayer). The deduction is allowable in computing AMT income and Missouri has adopted its provisions as well.

***Who is eligible for the deduction?*** The U.S. production activities deduction is allowed with respect to a taxpayer's qualified production activities income, which are the taxpayer's domestic production gross receipts net of expenses. "Domestic production gross receipts" are receipts derived from any of the following:

- Any lease, rental, license, sale, exchange, or other disposition of qualifying production property (i.e., tangible personal property, any computer software, and certain sound recordings) that was manufactured, produced, grown, or extracted in whole or in significant part by the taxpayer within the U.S.;
- Any qualified film produced by the taxpayer; or electricity, natural gas, and potable water produced by the taxpayer in the U.S.
- Construction performed in the U.S.
- Engineering and architectural services performed in the U.S. for construction projects in the U.S.

For pass-thru entities (such as S corporations, partnerships, estates and trusts), the deduction generally is determined at the shareholder, partner or similar level by taking into account the proportional share of the qualified production activities income and wages of the entity.

***Example.*** For example, a company that engages solely in manufacturing in the U.S. with taxable income of \$500,000 and wages exceeding \$1,000,000 will enjoy Federal and Missouri tax savings from this deduction of approximately \$18,000 when the deduction is fully phased in.

***So what's next?*** The rules surrounding this tax calculation are complex and clarifying regulations are still being written. We look forward to discussing with you how best to capture the necessary information to maximize your tax deduction and please contact us with any questions.

**STONE CARLIE & COMPANY, L.L.C.**