



Federal Tax Code Changes For Manufacturers

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Important Tax Relief for Manufacturers

If you haven't talked to your tax advisers yet about these important changes to the Internal Revenue Code effective in 2005, you may be missing out on a significant opportunity to reduce your company's (and possibly your own) tax liability.

Section 199

In October 2004, Congress gave final approval to the American Job Creation (JOBS) Act of 2004, which, among other things, provides tax relief for manufacturers in hopes of boosting domestic economic activity.

Effective January 1, 2005, JOBS amends Section 199 of the Internal Revenue Code to entitle U.S. manufacturers to a tax deduction for a portion of income from domestic production activities. The deduction applies to C and S corporations, sole proprietorships, partnerships, cooperatives, and estates and trusts.

Essentially, the tax deduction amounts to 3 percent of manufacturing-related income in 2005, and incrementally increases the rate to 9 percent of this income by 2010. The only significant limitations are that the deduction can't amount to more than 50 percent of your total manufacturing-related W-2 wages, it can only apply to activities attributable to domestic manufacturing, and it cannot exceed your total overall net income.

For example,

1. Let's say you sell \$5 million in structural components in 2005, and your manufacturing-related income is ten percent, or \$500,000.
2. Multiply the \$500,000 by 3 percent for a total of \$15,000, this is your allowable tax deduction.
3. Let's say your W-2 manufacturing wages total an additional \$500,000. Ensure that 50 percent of that amount (\$250,000) is greater than the 3 percent of income calculated above (\$15,000).
4. Next, look at your total net income, from all your operations (including your engineered wood products distribution business, for example). Let's say your EWP distribution ran at a loss of \$100,000, so your total net income was \$400,000. Since this deduction cannot cause your company to have a negative net income for tax purposes, ensure that your total net income is greater than the 3 percent of expenses calculated above (\$15,000). Again, in this case, it is.
5. As a result, your tax deduction is \$15,000!

Don't Delay! Congress is considering amending these tax code changes because they're concerned it may cost the government too much in lost tax revenue. Waiting until 2006 to utilize this tax deduction may mean you miss it entirely.

Section 179

An additional well kept secret is Section 179 of the Internal Revenue Code, which refers to depreciation of business assets. For 2005, you can claim an immediate, one-year depreciation on up to \$105,000 in assets purchased or placed in to service during the 2005 calendar year.

The deduction is voluntary, and in order to qualify you must purchase and put in to service at least \$105,000, but not more than \$420,000, in qualified assets. If you exceed the upper limit, you do not qualify for the program, and must depreciate all of these assets according to their normal schedule. In addition, anything over \$105,000 in assets are depreciated using their normal schedule.

What does this all mean? It means if you aren't set up to take advantage of these tax code changes for 2005, you need to start! With regards to the new Section 199 deduction opportunity, you will need to create a clear differentiation between your manufacturing-related and other business-related (shipping, distribution, administration, sales, etc.) expenses in order to file for the tax deduction. With respect to the Section 179 deduction, if you're planning on making a major purchase, either in manufacturing equipment or certain other assets, you may want to investigate whether you can split your asset purchases between 2005 and 2006 to remain under the \$420,000 threshold.

For more information on these tax code changes, refer to the SBC Legislative web site (www.sbcleg.com), and talk to your tax advisers about how you can benefit.