



## **Tax Relief For Engineers**

### *A. General*

As its primary provision, the American Jobs Creation Act of 2004, passed by the Senate on October 11, 2004, and to be sent to the President for signature, contains a new deduction designed to replace the former ETI/FSC benefit that was ruled illegal by the WTO. The new provision is the opposite of the one it replaced; instead of benefiting offshore activities and exports, it benefits domestic production. It applies to engineering companies.

### *B. Deduction Rules: Phase-in and Limitation*

Section 102 of the Act adds new Code section 199 providing for a deduction from income attributable to domestic production activities. The deduction is an amount equal to nine percent of the lesser of “qualified production activities income” or taxable income for the taxable year. The nine percent deduction is phased in; the transition percentage deduction is three percent for taxable years beginning in 2005 or 2006 and six percent for taxable years beginning in 2007 through 2009. The deduction cannot exceed 50 percent of W-2 wages of the employer for the taxable year, and regulations will spell out the computation if there are acquisitions or dispositions of a major portion of the taxpayer’s trade or business during a taxable year.

### *C. Definition of Qualifying Income*

“Qualified production activities income” is the excess of a taxpayer’s domestic production gross receipts for the taxable year over its costs of goods sold allocable to such receipts, its other deductions directly allocable to such receipts and a ratable portion of such deductions not directly allocable to such receipts. Again, Treasury is authorized to prescribe rules for the proper allocation of costs.

D. *Engineering Services*

Qualifying domestic production gross receipts include gross receipts derived from “engineering or architectural services performed in the United States for construction projects in the United States.” (The term “United States” includes only the 50 states and the District of Columbia.)

E. *S Corporations and Partnerships*

The deduction is granted to pass-through entities such as S corporations, partnerships and sole proprietorships, with the rules applied at the shareholder or partner level. The wage limitation is similarly applied, with a deemed allocation of the entity’s W-2 wages equal to the lesser of (i) the shareholder’s or partner’s allocable share of such wages or (ii) two times nine percent of the qualified production activities income allocated to such person (the 50 percent limitation).

F. *Alternative Minimum Tax*

Although IRC section 55, imposing the alternative minimum tax, is not amended, new Code section 199(d)(6) states that the deduction shall be allowed for purposes of computing alternative minimum taxable income. The intent is to allow the deduction for both the corporate and the individual alternative minimum tax.

G. *Regulations and Effective Date*

The Treasury would have considerable authority to prescribe regulations under the new provision, and the provision would take effect for taxable years beginning after December 31, 2004.

*This document was produced by Mr. Donald Alexander, partner in the law firm of Akin Gump Strauss Hauer & Feld, LLP, and former Commissioner of the Internal Revenue Service. This document is intended for use as general background information on the provisions of Section 102 of the American Jobs Creation Act of 2004, and should not be used for purposes of tax planning. Consult a tax advisor for specific tax advice regarding the provisions of this legislation.*