

Working Families Tax Relief Act of 2004

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I. Overview

- A. This bill includes individual and business tax extenders and breaks as well as several technical corrections.
- B. Total cost is about \$146 billion - \$132 billion for individuals - \$14 billion for businesses.
- C. In reality, the extenders and other provisions prevented the end of many tax benefits, thereby delaying an automatic tax increase.
- D. The new provisions don't address any of the FSC/ETI issues; those are still under consideration in conference. The hope is that they will be reported out in early October.

II. Individual Provisions

A. Child Credit

- 1. The \$1,000 credit amount is extended until the end of 2010, when it is sunset with the other provisions of EGTRRA. This provision takes effect in 2005.
- 2. The refundability of the credit in 2004 and future years is increased to 15% of earned income in excess of \$10,750 with indexing.
- 3. Combat pay (otherwise excluded from gross income under IRC Sec. 112) is treated as earned income for purposes of the refundable portion of the child credit if the taxpayer so elects. This election applies to calendar years 2004 and 2005.

B. Standard Deduction

- 1. The standard deduction for joint returns remains twice the standard deduction for single returns for 2005 through 2010.
- 2. The standard deduction provisions subject to the sunset provision of EGTRRA.

C. 15% Tax Rate

1. The 15% tax rate bracket for joint filers remains at twice the size of the corresponding tax bracket for single taxpayers from 2005 through 2010.
2. The 15% rate provisions are subject to the sunset provision of EGTRRA.

D. 10% Tax Rate

1. The size of the 10-percent rate bracket for 2005 through 2010 is set at the 2003 level (\$7,000 for single individuals, \$10,000 for heads of households and \$14,000 for married individuals) with annual indexing from 2003.
2. The 10-percent rate provisions are subject to the sunset provision of EGTRRA.

E. AMT Changes

1. The exemption amount of \$58,000 for joint filers, \$40,250 for single filers and \$29,000 for separate filers is extended through 2005.
2. Nonrefundable personal tax credits (i.e., the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child tax credit, the credit for interest on certain home mortgages, the HOPE Scholarship and Lifetime Learning credits, the credit for savers, and the D.C. first-time homebuyer credit) will be allowed in full against both regular and AMT tax for 2004 and 2005.
3. Congress continues to refuse to address the serious problem AMT poses to the tax system, instead relying on a number of short-term extensions to offset the impact of AMT.

F. Uniform definition of a qualifying child

1. There are currently five different definitions of a qualifying child. The new law establishes a uniform definition for purposes of the
 - a. dependency exemption
 - b. child credit
 - c. earned income credit

- d. dependent care credit
 - e. head of household filing status
2. Generally, a child is a qualifying child if the child satisfies the following three tests:
- a. the child has the same principal place of abode as the taxpayer for more than one half the taxable year (see 4 below);
 - b. the child has a specified relationship to the taxpayer (see 5 below); and
 - c. the child has not yet attained a specified age (see 6 below).
3. A tie-breaking rule applies if more than one taxpayer claims a child as a qualifying child.
- a. First, if only one of the individuals claiming the child as a qualifying child is the child's parent, the child is deemed the qualifying child of the parent.
 - b. Second, if both parents claim the child and the parents do not file a joint return, then the child is deemed a qualifying child first with respect to the parent with whom the child resides for the longest period of time, and second with respect to the parent with the highest adjusted gross income.
 - c. Third, if the child's parents do not claim the child, then the child is deemed a qualifying child with respect to the claimant with the highest adjusted gross income.
4. The residency test does not include temporary absences due to special circumstances, including absences due to illness, education, business, vacation, or military service.
5. The child must be the taxpayer's
- a. Son
 - b. Daughter
 - c. Stepson
 - d. Stepdaughter

- e. Brother
 - f. Sister
 - g. Stepbrother
 - h. Stepsister
 - i. A descendant of any such individual
 - j. An individual legally adopted by the taxpayer or an individual who is lawfully placed with the taxpayer for legal adoption by the taxpayer, is treated as a child of such taxpayer by blood.
 - k. A foster child who is placed with the taxpayer by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction is treated as the taxpayer's child.
6. The age requirements vary with the tax provision involved. In general, a child must be under age 19 (or under age 24 in the case of a full-time student) in order to be a qualifying child. In general, no age limit applies with respect to individuals who are totally and permanently disabled within the meaning of Sec. 22(e)(3) at any time during the calendar year. The law retains the present-law requirements that a child must be under age 13 (if he or she is not disabled) for purposes of the dependent care credit, and under age 17 (whether or not disabled) for purposes of the child credit.
7. A child who provides over one half of his or her own support generally is not considered a qualifying child of another taxpayer. However, a child who provides over one half of his or her own support may constitute a qualifying child of another taxpayer for purposes of the earned income credit.
- G. Combat pay otherwise excludable can be treated as earned income for the earned income credit through 2005.
- H. The above-the-line deduction for eligible educators is extended for tax years beginning in 2004 and 2005.

III. Business Provisions

A. The law extends Tax Code provisions that expired in 2003. The provisions were extended without modification through 2005.

1. Research and development tax credit
2. Mental health parity
3. Work Opportunity Tax Credit (WOTC) and the Welfare-to-Work tax credit
4. Qualified Zone Academy Bonds
5. Higher limit on the cover over of rum excise taxes to Puerto Rico and the Virgin Islands
6. Deduction for computer donations
7. Expensing of "Brownfields" environmental remediation costs
8. Authority to issue New York Liberty Zone bonds (extended through 2009)
9. Advance refunding of Liberty Zone bonds
10. Tax incentives for investment in the District of Columbia
11. Combined employment tax reporting demonstration project
12. Tax credit for electricity produced from renewable sources
13. Suspension of 100 percent of taxable income limit with respect to marginal production
14. Indian employment tax credit
15. Accelerated depreciation for business property on Indian reservations
16. Disclosure of tax return information for student loan repayment administration
17. Tax credit for electric vehicles
18. Deduction for clean-fuel vehicles

19. Archer MSAs
20. Disclosures relating to terrorist activities
21. Joint Committee on Taxation report and joint hearing on IRS strategic plans

B. Congress has again delayed deciding on the permanency of these provisions.

IV. Technical Corrections

- A. The additional tax on distributions from Archer MSA accounts is added to the list of additional taxes under Sec. 26(b).
- B. Distributions from a Health Savings Account are not included in determining the health coverage tax credit an individual is entitled to receive.
- C. The determination of net capital gains for purposes of determining the 25% depreciation recapture does not include dividends.
- D. The extraordinary dividend rule applies to trusts and estates as well as individuals.
- E. The holding period requirement for the dividends-received deduction under section 246(c) is changed from 90 days to 91 days (and from 180 days to 181 days in the case of certain dividends on preferred stock).
- F. The law also modifies the holding period requirement for dividends to be taxed at the tax rates applicable to net capital gain by changing from 120 days to 121 days (and from 180 days to 181 days in the case of certain dividends on preferred stock) the period within which a taxpayer may satisfy the requirement.
- G. The new law clarifies that qualifying property for bonus depreciation purposes includes property that is subject to the capitalization rules of section 263A and is described in the provisions requiring an estimated production period exceeding 2 years or an estimated production period exceeding 1 year and a cost exceeding \$1 million.
- H. Property qualifying for additional first-year depreciation does not include any property if the user or a related party to the user or owner of such property had a written binding contract in effect for the acquisition of the property at any time on or before September 10, 2001 (or, in the case of self-constructed property, the manufacture, construction, or production of the property began on or before September 10, 2001).

- I. Only NOLs arising in tax years ending in 2001 or 2002 qualify for the five-year carryback.
- J. Corrections to the Coverdell Savings Plans now coordinate this program with the Hope and Lifetime Learning Credits.
- K. The maximum amount of adjusted net capital gain eligible for the five-percent rate under the alternative minimum tax 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 (for example, \$56,800 for a joint return in 2003) over the taxable income reduced by the adjusted net capital gain.