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***What is a “Qualified Domestic Producer?”***

It was expected that the new “manufacturing” deduction would be available to a broad range of business operations. Now, the initial guidance floodgates (*IRS Notice 2005- 14*).

Details: Under the *American Jobs Creation Act* signed in October 2004, qualified domestic producers may be entitled to a deduction under new Internal Revenue Code Section 199 equal to a fixed percentage of the lesser of their taxable income or taxable income from “qualified production activities” (defined below).

The write-off is phased in between 2005 and 2010 according to the following schedule: 3 percent for tax years 2005 and 2006; 6 percent for years beginning in 2007 through 2009; and the full 9 percent for years beginning in 2010 and beyond.

Once it’s fully phased in, the deduction will be nearly equivalent to a 3 percent federal income tax rate cut for qualifying domestic production activities. This assumes the taxpayer pays the maximum 35 percent federal rate (9 percent deduction times 35 percent tax rate equals 3.15 percent effective tax rate cut).

Obviously, the deduction is available to traditional manufacturers of goods, food and clothing. However, the IRS has also extended this tax break to production activities in the following areas:

Construction,  
Music recordings and film production  
Electrical and natural gas,  
Unbottled drinking water production,  
Engineering and architecture services, and  
Software development.

The IRS announced it will provide additional guidance for these activities in forthcoming regulations, which are expected within the next few months.

The IRS guidance also provides several “safe harbor rules” to ease administrative burdens for small businesses. For instance, production activities in the U.S. must be “substantial” in order to qualify for the deduction. The IRS says this test will be met by qualified small businesses if their labor and overhead costs for the manufacture, production growth and extraction of property equals at least 20 percent of the total cost for the property.

*Note:* The manufacturing deduction can be claimed by any type of business entity, including C corporations, S corporations, limited liability companies (LLCs), partnerships and sole proprietors. Consult with your tax consultant to see if your business

qualifies and find out how you can maximize this benefit.

### **Definition of Qualified Production Activities Income**

Qualified Production Activities Income is described by the IRS as the excess of domestic production gross receipts over the sum of:

1. The costs of goods sold allocable to such receipts.
2. Other deductions, expenses, or losses directly allocable to such receipts.
3. A ratable portion of deductions, expenses, and losses not directly allocable to such receipts or another class of income.

### **IRS Unveils The Roth 401(k) Plan**

There will soon be a new way to set aside money for retirement—the Roth 401(k). The IRS recently released proposed regs on this retirement saving vehicle slated to become available in 2006.

The Roth 401(k) plan is essentially what it sounds like—a Roth IRA available through 401(k) plan. Generally, employees can elect to defer pre-tax contributions to a company 401(k) plan where the funds accumulate without current tax until withdrawn.

With a Roth IRA, unlike a traditional IRA, contributions are never tax deductible, but qualified distributions are tax-free.

The proposed regulations outline three steps for this hybrid plan:

The employee must make an irrevocable designation of a Roth contribution at the time of the deferral.

Contributions must be treated by the employer as taxable compensation as if the employee had received cash.

The Roth contributions must be maintained in a separate account. Separate accounting will apply to the contributions and earnings until all Roth contributions have been distributed.

Many standard nondiscrimination and nonforfeiture rules for 401(k)s remain in effect. However, unlike the stand-alone Roth IRA, this contribution option will be available for all plan participants, regardless of the amount of their income. In addition, lifetime distributions from a Roth 401(k) are mandatory.

The new saving vehicles were part of a tax law passed in May 2001 but companies are not allowed to start offering Roth 401(k)s until January 1, 2006.

### **Fixing Reconciliation Errors**

Whether using a manual or a QuickBooks® process, the bank reconciliation is essential to verifying the accuracy of cash account balances. It is equally important to preserve the bank statements and reconciliation reports that document this process. Because most business transactions include cash, the potential error is greater here than anywhere else.

One of the most common problems with the QuickBooks® bank reconciliation is that the beginning balance does not match the opening balance on the bank statement. The Beginning Balance equals the total value of previously cleared transactions. If you alter or delete a previously cleared transaction, the Beginning Balance will differ from the previous bank reconciliation. Choose *Locate Discrepancy* in the Begin Reconciliation window to investigate the variance.

Another problem occurs when you click the *Reconcile Now* button before you actually complete the bank reconciliation process. QuickBooks® creates a bank reconciliation adjustment for the difference between the cleared balance and the ending balance, and posts the difference to the Opening Balance Equity account. This only creates future problems for the accountant, as he/she will still have to locate and resolve the problem prior to preparing a financial statement or tax return. Under the Locate Discrepancies button, there is an Undo Last Reconciliation feature. Undoing the previous reconciliation *unclears* all the transactions for that reconciliation period, allowing you to begin the bank reconciliation process again. Once the reconciliation is corrected and completed, QuickBooks® will save the bank reconciliation report as a .PDF file. This static report will be useful if there is ever a need to troubleshoot differences in the beginning balance.

If you are still stuck, we can help –Contact us!

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**IRS Reminds Taxpayers that Heavy Vehicle Use Tax Can No Longer Be Paid in Installments (IR-2005-68)**

The IRS has reminded truckers and other owners of heavy highway vehicles that, beginning with the Form 2290 for the July 1, 2005 to June 30, 2006 tax year, they can no longer use the installment option to pay the federal heavy vehicle use tax (HVUT) under Code Sec. 4481. Instead, the balance due shown on the form must be paid in full by the due date of the return - in most cases, by August 31, 2005. This change was effected by the American Jobs Creation Act of 2004 (P.L. 108-357). The IRS has also reminded taxpayers of two other changes made by the 2004 Jobs Act: reduced HVUT rates for Canadian and Mexican vehicles were repealed, and taxpayers with at least 25 vehicles must file their Forms 2290 electronically.