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Highlights of 2004 Tax Changes

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Contents

Introduction

This publication highlights tax law changes that take effect in 2004, 2005, and later years. The chapters are divided into sections based on when the changes take effect.

Changes covered in this publication include the following.

- A uniform definition of child for tax purposes.
- New state and local general sales tax deduction.
- Extension of the deduction for certain expenses of educators.
- New deduction for costs involving discrimination suits.
- Changes to the child tax credit and earned income credit for individuals receiving combat pay.
- Extension of certain business-related tax credits, including the research credit and the welfare-to-work credit.

Publication 17, Your Federal Income Tax, is a comprehensive guide for preparing your 2004 income tax return. The tax tables reproduced in the publication as drafts are final and may be used to compute your 2004 tax. See chapter 8 for information on ordering Publication 17 and other forms and publications.

Adjusting your withholding or estimated tax payments for 2005. If your tax for 2005 will be more or less than your 2004 tax, you may need to adjust your withholding or estimated tax payments accordingly. If your tax will decrease, you can get the benefit of lower taxes throughout the year. If you will owe more tax, you can avoid a penalty when you file your tax return.

See the following table for forms and publications that will help you adjust your withholding or estimated tax payments. See chapter 8 for information on ordering forms and publications.

To adjust your...	Get Form...	And Publication...
Withholding	**W-4,** Employee's Withholding Allowance Certificate	**919,** How Do I Adjust My Tax Withholding?
Estimated tax payments	**1040-ES,** Estimated Tax for Individuals	**505,** Tax Withholding and Estimated Tax

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1-800-THE-LOST (1-800-843-5678)** if you recognize a child.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

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You can email us at **taxforms@irs.gov*. (The asterisk must be included in the address.) Please put "Publications Comment" on the subject line. Although we cannot respond individually to each email, we do appreciate your feedback and will consider your comments as we revise our tax products.

1.

Tax Changes for Individuals

2004 Changes

Credit for Child and Dependent Care Expenses for 2002 and 2003

If you claimed the credit for child and dependent care expenses in 2002 or 2003, you may be entitled to a larger credit. The definition of earned income in the 2002 and 2003 instructions for Form 2441 and Schedule 2 (Form 1040A) and Publication 503 incorrectly omitted nontaxable earned income. See the 2004 versions of the instructions for Form 2441 and Schedule 2 (Form 1040A) and Publication 503 for the correct definition of earned income.

If you are entitled to a larger credit because you had nontaxable earned income in 2002 or 2003, you must file Form 1040X, Amended U.S. Individual Income Tax Return. Generally, you must file Form 1040X within 3 years after the date you filed your original return or within 2 years after you paid the tax, whichever is later. See Form 1040X and its separate instructions.

Higher Taxable Income Limits for Using Form 1040A, 1040EZ, and TeleFile

Beginning with the 2004 return, the income limit for using Form 1040A, Form 1040EZ, and TeleFile increases to taxable income of less than $100,000. Previously, the limit was taxable income of less than $50,000. See the instructions for other requirements to use these forms.

Tuition and Fees Deduction

Beginning in 2004, the amount of qualified education expenses you can take into account in figuring your tuition and fees deduction increases from $3,000 to $4,000 if your modified adjusted gross income (MAGI) is not more than $65,000 ($130,000 if you are married filing jointly). If your MAGI is more than $65,000, but not more than $80,000 (more than $130,000, but not more than $160,000 if you are married filing jointly), your maximum tuition and fees deduction is $2,000. No tuition and fees deduction is allowed if your MAGI is more than $80,000 ($160,000 if you are married filing jointly). See chapter 6 of Publication 970, Tax Benefits for Education, for more information.

Distributions From Privately-Sponsored Qualified Tuition Programs (QTPs) May Be Tax Free

Beginning in 2004, if you receive a distribution from a QTP established and maintained by an eligible educational institution (generally private colleges and universities), you can exclude it from income to the extent of qualified education expenses. For more information on tax-free QTP distributions, see chapter 8 in Publication 970, Tax Benefits for Education.

Income Limits Increased for Hope and Lifetime Learning Credits

For 2004, the amount of your Hope or lifetime learning credit is phased out (gradually reduced) if your modified adjusted gross income (MAGI) is between $42,000 and $52,000 ($85,000 and $105,000 if you file a joint return). You cannot claim an education credit if your MAGI is $52,000 or more ($105,000 or more if you file a joint return). This is an increase from the 2003 limits of $41,000 and $51,000 ($83,000 and $103,000 if filing a joint return). For more complete information, see chapters 2 and 3 in Publication 970, Tax Benefits for Education.

Income Limits Increased for Reduction of Education Savings Bond Exclusion

For 2004, the amount of your interest exclusion will be phased out (gradually reduced) if your filing status is married filing jointly or qualifying widow(er) and your modified adjusted gross income (MAGI) is between $89,750 and $119,750. You cannot take the deduction if your MAGI is $119,750 or more. For 2003, the limits that applied to you were $87,750 and $117,750.

For all other filing statuses, your interest exclusion is phased out if your MAGI is between $59,850 and $74,850. You cannot take a deduction if your MAGI is $74,850 or more. For 2003, the limits that applied to you were $58,500 and $73,500. For more complete information, see chapter 10 in Publication 970, Tax Benefits for Education.

Student Loan Interest Deduction

Final regulations changed the following rules for deducting student loan interest. These changes apply to interest due and paid after December 31, 1997, on qualified student loans. For more complete information, see chapter 4 in Publication 970, Tax Benefits for Education.

Longer period allowed for loan disbursement. The 60-day safe harbor for disbursing loan proceeds used to pay qualified education expenses was increased to 90 days before and 90 days after the academic period to which the expenses relate.

Interest paid by a third party may be deductible. The person legally obligated to make interest payments on a student loan may be able to deduct interest payments on that loan made by someone else (third party).

Student Loan Repayment Assistance May Be Tax Free

Beginning in 2004, student loan repayments provided to you under certain federal and state repayment programs are tax free. For more information, see chapter 5 in Publication 970, Tax Benefits for Education.

Educator Expenses Deduction Extended

If you were an eligible educator in 2004, you can deduct as an adjustment to income up to $250 of qualified expenses you paid in 2004. This provision was scheduled to expire at the end of 2003. However, it was extended through 2005. For more information on the deduction, see Publication 529, Miscellaneous Deductions.

Health Savings Accounts (HSAs)

A health savings account (HSA) is a tax-exempt trust or custodial account that you set up with a qualified HSA trustee to pay or reimburse certain medical expenses you incur. You must be an eligible individual to have contributions made to your HSA. For 2004, you can deduct contributions made on or before April 15, 2005, to your 2004 HSA. For more information on HSAs, see Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans.

Archer Medical Savings Accounts (MSAs) Extended

The period for opening a new Archer MSA has been extended until December 31, 2005. Previously, this period was scheduled to expire at the end of 2003. Archer MSAs are explained in Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans.

Unlawful Discrimination Claims

You may be able to deduct as an adjustment to income attorney fees and court costs paid after October 22, 2004, for actions settled or decided after that date involving a claim of unlawful discrimination, a claim against the United States Government, or a claim made under section 1862(b)(3)(A) of the Social Security Act. However, you cannot deduct more than the amount you received from the claim that was included in gross income for the tax year. For more information, see Publication 525, Taxable and Nontaxable Income.

Exclusion of Gain Not Allowed on Home Acquired in Like-Kind Exchange

Generally, you can exclude from income a gain from selling property you used as your main home for at least 2 years during the 5-year period ending on the date of sale. However, you cannot exclude a gain from selling your home after October 22, 2004, if you acquired the property in a like-kind exchange and sold it during the 5-year period beginning on the date you acquired it. For more information, see Publication 523, Selling Your Home.

State and Local General Sales Tax Deduction

For 2004 and 2005, you can elect to deduct state and local general sales taxes instead of state and local income taxes as an itemized deduction on Schedule A (Form 1040). You cannot deduct both. Generally, to figure your state and local sales tax deduction, you can use either your actual expenses or the tables contained in Publication 600, Optional State Sales Tax Tables.

If you use the tables to figure your deduction, you may be able to add the following items to the table amount.

- Local general sales taxes if your locality imposes a general sales tax.
- State and local general sales taxes paid on a motor vehicle (including a leased motor vehicle), aircraft, boat, home (including mobile and prefabricated), or home building materials.

See the Instructions for Schedule A (Form 1040) and Publication 600 for details.

Contributions for Relief of Tsunami Victims

You can treat cash contributions made in January 2005 for the relief of victims in areas affected by the December 26, 2004, Indian Ocean tsunami as if you had made them on December 31, 2004. These contributions must otherwise qualify as deductible contributions. Contributions you deduct on your 2004 tax return cannot be deducted on your 2005 tax return.

Charitable Contributions of Patents and Other Intellectual Property

If you donate a patent or other intellectual property to a qualified organization after June 3, 2004, your deduction is limited to the basis of the property or the fair market value of the property, whichever is less. Intellectual property means any of the following:

- Patents.
- Copyrights (other than a copyright described in Internal Revenue Code sections 1221(a)(3) or 1231(b)(1)(C)).
- Trademarks.
- Trade names.
- Trade secrets.
- Know-how.
- Software (other than software described in Internal Revenue Code section 197(e)(3)(A)(i)).
- Other similar property or applications or registrations of such property.

Additional deduction based on income. You also may be able to claim additional charitable contribution deductions in the year of the contribution and years following, based on the income, if any, from the donated property.

The following table shows the percentage of the organization's income from the property that you can deduct for each of your tax years ending on or after the date of the contribution. In the table, "tax year 1," for example, means your first tax year ending on or after the date of the contribution. However, you can take the additional deduction only to the extent the total of the amounts figured using this table is more than the amount of the deduction claimed for the original donation of the property.

Tax year	Deductible percentage
1	100%
2	100%
3	90%
4	80%
5	70%
6	60%
7	50%
8	40%
9	30%
10	20%
11	10%
12	10%

After the legal life of the patent or other intellectual property ends or after the 10th anniversary of the donation, no additional deduction is allowed.

The additional deductions cannot be taken for patents or other intellectual property donated to certain private foundations.

Reporting requirements. You are required to inform the organization at the time of the donation that you intend to treat the donation as a contribution subject to the provisions discussed above. The organization is required to file an information return showing the income from the property and give you a copy of the return.

More information. The IRS expects to issue more guidance on these rules early in 2005. To find out if that guidance has been issued, check the Internal Revenue Bulletin or *www.irs.gov*.

Charitable Contributions of Property Over $500,000

If you claim a deduction of more than $500,000 for a contribution of property made after June 3, 2004, you must attach a qualified appraisal of the property to your return. This does not apply to contributions of cash, inventory, publicly traded stock, or intellectual property. Previously, the appraisal was required for your records but did not have to be attached to your return.

If you do not attach the appraisal, you cannot deduct your contribution, unless your failure to attach the appraisal is due to reasonable cause and not to willful neglect.

More information. The IRS expects to issue more guidance on the new appraisal rules early in 2005. To find out if that guidance has been issued, check the Internal Revenue Bulletin or *www.irs.gov*. For general information about appraisals, see *Qualified Appraisal* in Publication 561, Determining the Value of Donated Property.

Exemption Amount Increased

The amount you can deduct for each exemption has increased from $3,050 in 2003 to $3,100 in 2004.

You lose all or part of the benefit of your exemptions if your adjusted gross income is above a certain amount. The amount at which the phaseout begins depends on your filing status. For 2004, the phaseout begins at:

- $107,025 for married persons filing separately,
- $142,700 for single individuals,
- $178,350 for heads of household, and
- $214,050 for married persons filing jointly or qualifying widow(er)s.

If your adjusted gross income is above the amount for your filing status, use the *Deduction for Exemptions Worksheet* in the Form 1040 or Form 1040A instructions to figure the amount you can deduct for exemptions.

Standard Deduction Amount Increased

The standard deduction for people who do not itemize deductions on Schedule A of Form 1040 is, in most cases, higher for 2004 than it was for 2003. The amount depends on your filing status, whether you are 65 or older or blind, and whether an exemption can be claimed for you by another person. The *2004 Standard Deduction Tables* are shown in Publication 501, Exemptions, Standard Deduction, and Filing Information.

Limit on Itemized Deductions Increased

If your adjusted gross income is above a certain amount, you lose all or part of your itemized deductions. In 2004, this amount is increased to $142,700 ($71,350 if married filing separately). In 2003, the amount was $139,500 ($69,750 if married filing separately). For more information and a worksheet to figure the amount you can deduct, see Schedule A (Form 1040) instructions for line 28.

Investment Income of Child Under Age 14

The amount of taxable investment income a child under age 14 can have without it being subject to tax at the parent's rate has increased to $1,600 for 2004. Previously, the amount was $1,500.

Dependent Care Benefits

You can generally elect to include nontaxable combat pay in earned income for figuring the amount of dependent care benefits you can exclude or deduct from income. You may be able to increase your exclusion or deduction by making the election. For more information on dependent care benefits, see Publication 503, Child and Dependent Care Expenses.

TIP *You can make a separate election to have your nontaxable combat pay included in earned income if you are claiming the earned income credit. In other words, you can choose to include your nontaxable combat pay in earned income when figuring your exclusion or deduction of dependent care benefits, even if you choose not to include it in earned income for the earned income credit.*

Additional Child Tax Credit Expanded

The credit limit based on earned income is increased to 15% (previously 10%) of your earned income that exceeds $10,750. If you were a member of the U.S. Armed Forces who served in a combat zone, your nontaxable combat pay counts as earned income when figuring this credit limit. See Form 8812, Additional Child Tax Credit, for more information.

Health Coverage Tax Credit

Beginning in 2004, you cannot claim the health coverage tax credit for premiums that you pay with a tax-free distribution from your health savings account. See Form 8885, Health Coverage Tax Credit, and Publication 502, Medical and Dental Expenses, for more information on this credit.

Earned Income Credit Amounts Increased

The following paragraphs explain the changes to the credit for 2004. For details, see Publication 596, Earned Income Credit.

Nontaxable combat pay election. You can elect to have your nontaxable combat pay included in earned income for the earned income credit (EIC). If you are filing jointly and both you and your spouse received nontaxable combat pay, each of you can make your own election. In other words, one of you can choose to include your nontaxable combat pay in earned income, and the other one can choose not to include it. Electing to include nontaxable combat pay in earned income may increase or decrease your EIC. Figure the credit with and without your nontaxable combat pay before making the election.

The election cannot be made on the return of a taxpayer whose tax year ended before October 5, 2004, due to his or her death.

TIP *You can make a separate election to have your nontaxable combat pay included in earned income if you are excluding or deducting dependent care benefits from income. In other words, you can choose to include your nontaxable combat pay in earned income when figuring your exclusion or deduction of dependent care benefits, even if you choose not to include it in earned income for the EIC.*

Earned income amount is more. The maximum amount of income you can earn and still get the credit has increased. You may be able to take the credit if:

- You have more than one qualifying child and you earned less than $34,458 ($35,458 if married filing jointly),
- You have one qualifying child and you earned less than $30,338 ($31,338 if married filing jointly), or
- You do not have a qualifying child and you earned less than $11,490 ($12,490 if married filing jointly).

The maximum amount of adjusted gross income (AGI) you can have and still get the credit has also increased. You may be able to take the credit if your AGI is less than the amount in the above list that applies to you.

Investment income amount is more. The maximum amount of investment income you can have and still get the credit has increased to $2,650.

Electric and Clean-Fuel Vehicles

The maximum clean-fuel vehicle deduction and qualified electric vehicle credit were scheduled to be 25% lower for 2004 and 50% lower for 2005. The full deduction and credit are now allowed for qualified property placed in service in 2004 and 2005. The deduction and credit are still scheduled to be reduced by 75% for qualified property placed in service in 2006, and no deduction or credit will be allowed after 2006. For more information about electric and clean-fuel vehicles, see chapter 12 in Publication 535, Business Expenses.

Straddle Rules

Changes to the straddle rules went into effect for positions established after October 21, 2004. In general, the new rules:

- Allow you to identify offsetting positions of a straddle,
- Clarify how to treat certain physically settled positions of a straddle, and
- Repeal the stock exception from the straddle rules.

The changes are described in chapter 4 of Publication 550, Investment Income and Expenses.

Rural Mail Carriers

Beginning in 2004, if you are a rural mail carrier and your allowable vehicle expenses are more than your qualified reimbursement, you can deduct the unreimbursed expenses as a miscellaneous itemized deduction on Schedule A (Form 1040). You must complete Form 2106 and attach it to your Form 1040. See chapter 4 of Publication 463, Travel, Entertainment, Gift, and Car Expenses, for more information on allowable expenses and qualified reimbursements.

Standard Mileage Rate

Business-related mileage. For 2004, the standard mileage rate for the cost of operating your vehicle is increased from 36 cents a mile to 37½ cents a mile for all business miles.

Car expenses and use of the standard mileage rate are explained in chapter 4 of Publication 463, Travel, Entertainment, Gift, and Car Expenses.

Medical and move-related mileage. For 2004, the standard mileage rate for the cost of operating your vehicle for medical reasons or as part of a deductible move is increased from 12 cents a mile to 14 cents a mile. See *Transportation* under *What Medical Expenses Are Includable* in Publication 502, Medical and Dental Expenses, or *Travel by car* under *Deductible Moving Expenses* in Publication 521, Moving Expenses.

2005 Changes

Uniform Definition of a Qualifying Child

Beginning in 2005, one definition of a “qualifying child” will apply for each of the following tax benefits.

- Dependency exemption.
- Head of household filing status.
- Earned income credit (EIC).
- Child tax credit.
- Credit for child and dependent care expenses.

Tests To Meet

In general, all four of the following tests must be met to claim someone as a qualifying child.

Relationship test. The child must be your child (including an adopted child, stepchild, or eligible foster child), brother, sister, stepbrother, stepsister, or a descendent of one of these relatives.

An adopted child includes a child lawfully placed with you for legal adoption even if the adoption is not final.

An eligible foster child is any child who is placed with you by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.

Residency test. The child must live with you for more than half of the year. Temporary absences for special circumstances, such as for school, vacation, medical care, military service, or detention in a juvenile facility count as time lived at home. A child who was born or died during the year is considered to have lived with you for the entire year if your home was the child’s home for the entire time he or she was alive during the year. Also, exceptions apply, in certain cases, for children of divorced or separated parents and parents of kidnapped children. For more information, see Publication 501, Exemptions, Standard Deduction, and Filing Information.

Age test. The child must be under a certain age (depending on the tax benefit) to be your qualifying child.

Dependency exemption, head of household filing status, and EIC. For purposes of these tax benefits, a child must be under age 19 at the end of the year, or under age 24 at the end of 2005 if a student, or any age if permanently and totally disabled.

A student is any child who, during any 5 months of the year:

- Was enrolled as a full-time student at a school, or
- Took a full-time, on-farm training course given by a school or a state, county, or local government agency.

A school includes a technical, trade, or mechanical school. It does not include an on-the-job training course, correspondence school, or night school.

Child tax credit. For purposes of the child tax credit, a child must be under the age of 17.

Credit for child and dependent care expenses. For purposes of the credit for child and dependent care expenses, a child must be under the age of 13 or any age if permanently and totally disabled.

Support test. The child cannot have provided over half of his or her own support during the year. For the definition of support, see *Support Test*, in Publication 501.

Exception. For purposes of the EIC only, the support test does not apply.

Qualifying Child of More Than One Person

Sometimes a child meets the tests to be a qualifying child of more than one person. However, only one person can treat that child as a qualifying child. If you and someone else (other than your spouse if filing jointly) have the same qualifying child, you and the other person(s) can decide who will claim the child. If you cannot agree on who will claim the child and more than one person files a return using the same child, the IRS may disallow one or more of the claims using the tie-breaker rule explained in Table 1, below.

Dependency Exemption

To claim the dependency exemption for a qualifying child, all four tests listed earlier under *Tests To Meet* must be met. The child generally must also be a U.S. citizen, U.S. national, or a resident of the United States, Canada, or Mexico. An exception applies for certain adopted children. If married, the child cannot file a joint return unless the return is filed only as a claim for refund and no tax liability would exist for either spouse if they had filed separate returns.

A person who used to qualify as your dependent but who is not your "qualifying child" may still qualify as your dependent as a "qualifying relative." To claim the dependency exemption for a qualifying relative, the person cannot be the qualifying child of any other person and all five dependency tests discussed under *Dependency Tests* in Publication 501 must be met.

CAUTION *If you are a dependent of another person, you cannot claim any dependents on your return.*

Head of Household Filing Status

In general, you can use head of household filing status only if, as of the end of the year, you were unmarried or "considered unmarried" and you paid over half the cost of keeping up a home:

1. That was the main home for the entire year of your parent whom you can claim as a dependent (your parent did not have to live with you), or
2. In which you lived for more than half of the year with either of the following:
   a. Your qualifying child (defined earlier, but without regard to the exception for children of divorced or separated parents). But, if your qualifying child is married at the end of the year, see *Married child,* later.
   b. Any other person whom you can claim as a dependent.

Table 1. **When More Than One Person Files a Return Claiming the Same Qualifying Child (Tie-Breaker Rule)**

IF . . .	**THEN the child will be treated as the qualifying child of the. . .**
only one of the persons is the child's parent,	parent.
both persons are the child's parent,	parent with whom the child lived for the longer period of time. If the child lived with each parent for the same amount of time, then the child will be treated as the qualifying child of the parent with the highest adjusted gross income (AGI).
none of the persons are the child's parent,	person with the highest AGI.

But you cannot use head of household filing status for a person who is your dependent only because:

- He or she lived with you for the entire year, or
- You are entitled to claim him or her as a dependent under a multiple support agreement.

Married child. If your qualifying child is married at the end of the year, both of the following must apply for the child to be your qualifying child for purposes of head of household filing status.

- The child cannot file a joint return unless the return is filed only as a claim for refund and no tax liability would exist for either spouse if they had filed separate returns.
- The child must be a U.S. citizen, U.S. national, or a resident of the United States, Canada, or Mexico. An exception applies for certain adopted children.

Earned Income Credit (EIC)

For purposes of the EIC, a qualifying child must meet the *Relationship test, Residency test* (without regard to the exception for children of divorced or separated parents), and *Age test,* discussed earlier. A qualifying child does not have to meet the *Support test* for purposes of the EIC. But, if your qualifying child is married at the end of the year, see *Married child,* below. For additional rules that you must meet to claim the EIC, see Publication 596, Earned Income Credit.

Married child. A child who is married at the end of the year is a qualifying child for purposes of the EIC only if you can claim him or her as your dependent (see *Dependency Exemption*, earlier) or this child's other parent claims him or her as a dependent under the rules for children of divorced or separated parents in Publication 501.

Child Tax Credit

You may be able to take the child tax credit if you have a qualifying child who meets all four of the tests listed earlier under *Tests To Meet*. For additional rules that you must meet, see Publication 972, Child Tax Credit.

Credit for Child and Dependent Care Expenses

Generally, a qualifying person for purposes of the credit for child and dependent care expenses is:

- Your qualifying child (defined earlier, but without regard to the exception for parents of kidnapped children), or
- Your dependent or spouse who is physically or mentally incapable of caring for himself or herself and who lived with you for more than half of the year.

For purposes of the credit for child and dependent care expenses, a qualifying child and dependent are determined without regard to the exception for children of divorced or separated parents and the child is treated as a qualifying person only for the custodial parent.

For additional rules that you must meet, see Publication 503, Child and Dependent Care Expenses. However, for 2005, you no longer need to meet the *Keeping Up a Home Test* discussed in Publication 503.

Section 1202 Exclusion Increased for Gain from Empowerment Zone Business Stock

You generally can exclude up to 50% of your gain on the sale or trade of qualified small business stock held by you for more than 5 years. This is called the section 1202 exclusion. Beginning in 2005, you generally can exclude up to 60% of your gain if you meet the following additional requirements.

1. You sell or trade stock in a corporation that qualifies as an empowerment zone business during substantially all of the time you held the stock.
2. You acquired the stock after December 21, 2000.

Item (1) will still be met if the corporation ceased to qualify after the 5-year period that begins on the date you acquired the stock. However, the gain that qualifies for the 60% exclusion cannot be more than the gain you would have had if you had sold the stock on the date the corporation ceased to qualify.

The part of the gain that is included in income is 28% rate gain. See *Capital Gain Tax Rates* in chapter 4 of Publication 550.

For more information about the section 1202 exclusion, see *Section 1202 Exclusion* in chapter 4 of Publication 550. For more information about empowerment zone businesses, see Publication 954, Tax Incentives for Distressed Communities.

Charitable Contributions of Cars, Boats, and Aircraft

If you donate a car to a qualified organization after December 31, 2004, your deduction is limited to the gross proceeds from its sale by the organization. This rule applies if the claimed value of the donated vehicle is more than $500. However, if the organization makes significant intervening use of or materially improves the car, you generally can deduct its fair market value.

Boats, aircraft, and other vehicles. These rules also apply to donations of boats, aircraft, and any vehicle manufactured mainly for use on public streets, roads, and highways.

Acknowledgement required. If the claimed value of the car is more than $500, you must have a written acknowledgement of your donation from the organization and must attach it to your return. If you do not have an acknowledgement, you cannot deduct your contribution.

The acknowledgement must include the following information.

1. Your name and taxpayer identification number.
2. The vehicle identification number or similar number.
3. A statement certifying the car was sold in an arm's length transaction between unrelated parties.
4. The gross proceeds from the sale.
5. A statement that your deduction may not be more than the gross proceeds from the sale.
6. The date of the contribution.

However, if there was significant intervening use of or material improvement to the car by the organization, the acknowledgement does not have to include the information in items 3, 4, and 5 above. Instead, it must contain a certification of the intended use of or material improvement to the car and the intended duration of that use and a certification that the vehicle will not be transferred in exchange for money, other property, or services before completion of that use or improvement.

This acknowledgement must be provided within 30 days of the sale of the car or, if there is significant intervening use or material improvement of the car by the organization, within 30 days of the contribution.

The organization also must provide this information to the IRS.

Donations of inventory. These rules do not apply to donations of inventory. For example, these rules do not apply if you are a car dealer who donates a car you had been holding for sale to customers.

More information. The IRS expects to issue more guidance on these rules early in 2005. To find out if that guidance has been issued, check the Internal Revenue Bulletin or *www.irs.gov*.

Exemption Amount Increases

The amount you can deduct for each exemption has increased from $3,100 in 2004 to $3,200 in 2005.

You lose all or part of the benefit of your exemptions if your adjusted gross income is above a certain amount. The amount at which the phaseout begins depends on your filing status. For 2005, the phaseout begins at:

- $109,475 for married persons filing separately,
- $145,950 for single individuals,
- $182,450 for heads of household, and
- $218,950 for married persons filing jointly or qualifying widow(er)s.

Standard Deduction Amount Increases

The standard deduction for people who do not itemize deductions on Schedule A of Form 1040 is, in most cases, higher for 2005 than it was for 2004. The amount depends on your filing status, whether you are 65 or older or blind, and whether an exemption can be claimed for you by another person. The *2005 Standard Deduction Tables* are shown in Publication 505, Tax Withholding and Estimated Tax.

Earned Income Credit (EIC) Amounts Increase

The following paragraphs explain the changes to the credit for 2005.

Earned income amount. The maximum income you can earn and still get the credit is higher for 2005 than it is for 2004. You may be able to take the credit for 2005 if:

- You have more than one qualifying child and you earn less than $35,263 ($37,263 if married filing jointly),
- You have one qualifying child and you earn less than $31,030 ($33,030 if married filing jointly), or
- You do not have a qualifying child and you earn less than $11,750 ($13,750 if married filing jointly).

The maximum adjusted gross income (AGI) you can have and still get the credit has also increased. You may be able to take the credit if your AGI is less than the amount in the above list that applies to you.

Investment income amount. The maximum investment income you can have in 2005 and still get the credit increases to $2,700.

Standard Mileage Rate

Business-related mileage. For 2005, the standard mileage rate for the cost of operating your vehicle is increased from 37½ cents a mile to 40½ cents a mile for all business miles.

Car expenses and use of the standard mileage rate are explained in chapter 4 of Publication 463, Travel, Entertainment, Gift, and Car Expenses.

Medical and move-related mileage. For 2005, the standard mileage rate for the cost of operating your vehicle for medical reasons or as part of a deductible move is increased from 14 cents a mile to 15 cents a mile. See *Transportation* under *What Medical Expenses Are Includable* in Publication 502, Medical and Dental Expenses, or *Travel by car* under *Deductible Moving Expenses* in Publication 521, Moving Expenses.

Social Security and Medicare Taxes

For 2005, the employer and employee will continue to pay:

1. 6.2% each for social security tax (old-age, survivors, and disability insurance), and
2. 1.45% each for Medicare tax (hospital insurance).

Wage limits. For social security tax, the maximum 2005 wages subject to the tax increased to $90,000. For Medicare tax, all covered 2005 wages are subject to the tax. For information about these taxes, see Publication 15 (Circular E), Employer's Tax Guide.

2.

Tax Changes for Businesses

2004 Changes

Weather-Related Sales of Livestock Reported After 2002

The following new rules apply to postponing gain on the sale or exchange of livestock (other than poultry) held for draft, breeding, or dairy purposes because of weather-related conditions. These rules are effective for tax years for which the return due date (excluding extensions) is after 2002.

1. If it is not practical for you to invest the sales proceeds in other livestock, other property (except real property) used for farming qualifies as replacement property.
2. The replacement period is at least 4 years, if the weather-related conditions occur in an area eligible for federal assistance.

If you do not replace the livestock, the due date for making an election to postpone reporting income from sales or exchanges because of weather-related conditions described in item (2) above is also extended.

For more information, see Publication 225, Farmer's Tax Guide.

Meal Expenses When Subject to "Hours of Service" Limits

Generally, you can deduct only 50% of your business-related meal expenses. You can deduct a higher percentage for meal expenses while traveling away from your tax home for business purposes if the meals take place during or incident to any period subject to the Department of Transportation's "hours of service" limits. (These limits apply to workers who are under certain federal regulations.) The percentage increases to 70% for 2004. Business meal expenses are covered in chapter 1 of Publication 463, Travel, Entertainment, Gift, and Car Expenses. Reimbursements for employee meal expenses are covered in chapter 13 of Publication 535, Business Expenses.

Contributions for Relief of Tsunami Victims

You can treat cash contributions made in January 2005 for the relief of victims in areas affected by the December 26, 2004, Indian Ocean tsunami as if you had made them on December 31, 2004. These contributions must otherwise qualify as deductible contributions. Contributions you deduct on your 2004 tax return cannot be deducted on your 2005 tax return.

Charitable Contributions of Patents and Other Intellectual Property

If you donate a patent or other intellectual property to a qualified organization after June 3, 2004, your deduction is limited to the basis of the property or the fair market value of the property, whichever is less. Intellectual property means any of the following:

- Patents.
- Copyrights (other than a copyright described in Internal Revenue Code sections 1221(a)(3) or 1231(b)(1)(C)).
- Trademarks.
- Trade names.
- Trade secrets.
- Know-how.
- Software (other than software described in Internal Revenue Code section 197(e)(3)(A)(i)).
- Other similar property or applications or registrations of such property.

Additional deduction based on income. You also may be able to claim additional charitable contribution deductions in the year of the contribution and years following, based on the income, if any, from the donated property.

The following table shows the percentage of the organization's income from the property that you can deduct for each of your tax years ending on or after the date of the contribution. In the table, "tax year 1," for example, means your first tax year ending on or after the date of the contribution. However, you can take the additional deduction only to the extent the total of the amounts figured using this table is more than the amount of the deduction claimed for the original donation of the property.

Tax year	Deductible percentage
1	100%
2	100%
3	90%
4	80%
5	70%
6	60%
7	50%
8	40%
9	30%
10	20%
11	10%
12	10%

After the legal life of the patent or other intellectual property ends or after the 10th anniversary of the donation, no additional deduction is allowed.

The additional deductions cannot be taken for patents or other intellectual property donated to certain private foundations.

Reporting requirements. You are required to inform the organization at the time of the donation that you intend to treat the donation as a contribution subject to the provisions discussed above. The organization is required to file an information return showing the income from the property and give you a copy of the return.

More information. The IRS expects to issue more guidance on these rules early in 2005. To find out if that guidance has been issued, check the Internal Revenue Bulletin or *www.irs.gov*.

Corporate Contributions of Property Over $5,000

All corporations generally must get a qualified appraisal of property donated after June 3, 2004, if claiming a deduction of more than $5,000. This does not apply to contributions of cash, inventory, publicly traded stock, intellectual property, or certain qualified vehicles for which a written statement from the donee organization is provided. Previously, most C corporations were not required to get an appraisal.

If a deduction of more than $500,000 is claimed, the appraisal must be attached to the corporation's return.

If the corporation does not meet these requirements, it cannot deduct the contribution, unless its failure to meet the requirements is due to reasonable cause and not to willful neglect.

More information. The IRS expects to issue more guidance on the new appraisal rules early in 2005. To find out if that guidance has been issued, check the Internal Revenue Bulletin or *www.irs.gov*. For general information about appraisals, see *Qualified Appraisal* in Publication 561, Determining the Value of Donated Property.

Corporate Contributions of Computer Technology and Equipment

The increased deduction for donations of qualified contributions of computer technology or equipment by a corporation to an eligible donee was scheduled to expire for tax years beginning after 2003. This provision is extended to contributions made during any tax year beginning before January 1, 2006.

Deduction for Costs of Qualified Film or Television Productions

For productions beginning after October 22, 2004, you can elect to deduct up to $15 million in production costs of a qualified film or television production. The aggregate costs of such a production cannot exceed $15 million. No other depreciation or amortization is allowed for a production for which you make the election. This deduction is increased to $20 million for a production if the costs are significantly incurred in certain economically depressed areas.

Business Start-Up Costs and Organizational Costs

For business start-up costs and organizational costs of corporations and partnerships paid or incurred after October 22, 2004, you can elect to deduct up to $5,000. This amount is reduced by the amount by which your start-up costs exceed $50,000. Also, the amortization period for certain business start-up costs and organizational costs paid or incurred after October 22, 2004, has been increased to 15 years. For details, see Publication 535, Business Expenses.

Depreciation and Section 179 Expense

Increased section 179 limits. The maximum section 179 deduction you can elect for property you placed in service in 2004 increased from $100,000 to $102,000 for qualified section 179 property ($137,000 for qualified zone property, qualified renewal property, or qualified New York Liberty Zone property). This limit is reduced by the amount by which the cost of section 179 property placed in service during the tax year exceeds $410,000 (increased from $400,000). See chapter 2 of Publication 946, How To Depreciate Property.

Depreciation limits on passenger automobiles. The total depreciation deduction (including the section 179 deduction and the special depreciation allowance) you can take for a passenger automobile (that is not a truck or van or an electric vehicle) that you use in your business and first place in service in 2004 is:

- $10,610 if you claim the 50% or 30% special allowance; or
- $2,960 if you elect not to claim any special allowance for the vehicle, the vehicle is not qualified property, or the vehicle is qualified Liberty Zone property.

CAUTION *The limits are reduced if the business use of the vehicle is less than 100%.*

Depreciation limits on trucks or vans. The total depreciation deduction (including the section 179 deduction and the special depreciation allowance) you can take for a truck or van (such as a minivan or a sport utility vehicle) built on a truck chassis that you use in your business and first place in service in 2004 is:

- $10,910 if you claim the 50% or 30% special allowance; or
- $3,260 if you elect not to claim any special allowance for the vehicle, the vehicle is not qualified property, or the vehicle is qualified Liberty Zone property.

CAUTION *The limits are reduced if the business use of the vehicle is less than 100%.*

Depreciation limits on electric vehicles. The total depreciation deduction (including the section 179 deduction and the special depreciation allowance) you can take for an electric vehicle that you use in your business and first place in service in 2004 is:

- $31,830 if you claim the 50% or 30% special allowance; or
- $8,880 if you elect not to claim any special allowance for the vehicle, the vehicle is not qualified property, or the vehicle is qualified Liberty Zone property.

CAUTION *The limits are reduced if the business use of the vehicle is less than 100%.*

More information. See *Maximum Depreciation Deduction* in chapter 5 of Publication 946.

Section 179 Deduction Limit for Sport Utility and Certain Other Vehicles

The maximum section 179 expense deduction for sport utility vehicles and certain other vehicles placed in service after October 22, 2004, is $25,000. For more information, see chapter 5 of Publication 946, How To Depreciate Property.

Modification of Depreciation Allowance for Aircraft

Certain non-commercial aircraft placed into service before January 1, 2006, may be eligible for the special depreciation allowance. For more information, see Publication 946, How To Depreciate Property.

Liberty Zone Leasehold Improvement Property

You can elect not to treat qualified New York Liberty Zone leasehold improvement property as 5-year property. If you make this election, depreciate the property using the rules for nonresidential real property if placed in service before October 23, 2004, and using the rules for qualified leasehold improvement property if placed in service after October 22, 2004. For more information, see Publication 946, How To Depreciate Property.

Special Placed in Service Rule for Certain Property Subject to Syndication

For purposes of meeting the placed in service rule for the special depreciation allowance, multiple units of property sold after June 4, 2004, that are subject to the same lease generally will qualify as placed in service on the date of sale if sold within 3 months after the final unit is placed in service. For more information and other rules for leases subject to syndication, see Publication 946, How To Depreciate Property.

Recovery Period for Depreciation of Certain Leasehold Improvements and Restaurant Property

Qualified leasehold improvement property and qualified restaurant property placed in service after October 22, 2004, and before January 1, 2006, is 15-year property under MACRS. You must use the straight line method over a 15-year recovery period (39 years if the alternative depreciation system (ADS) is elected or otherwise applies). For more information, see Publication 946, How To Depreciate Property.

Depreciation of Tax-Exempt Use of Computer Software Subject to a Lease

For depreciation purposes, the useful life of computer software leased under a lease agreement entered into after March 12, 2004, to a tax-exempt organization, governmental unit, or a foreign person or entity (other than a partnership), cannot be less than 125 percent of the lease term. For more information about depreciating computer software, see Publication 946, How To Depreciate Property.

Figuring Depreciation for Property Acquired in a Like-kind Exchange or Involuntary Conversion

New guidance has been issued for depreciating property acquired after February 27, 2004, in a like-kind exchange or involuntary conversion. You generally must depreciate the carryover basis of the acquired property over the remaining recovery period of the property exchanged or involuntarily converted. You also generally continue to use the same depreciation method and convention used for the exchanged or involuntarily converted property. The excess basis, if any, of the acquired property is treated as newly placed in service property.

For a like-kind exchange or involuntary conversion for which the date of disposition, replacement, or both was before February 28, 2004, you may follow these rules or rely on prior IRS guidance using any reasonable, consistent method of figuring depreciation.

For more information and special rules, see Publication 946.

Expensing EPA Sulfur Regulations Costs

A small business refiner can now elect to expense, rather than depreciate, 75% of qualifying costs of complying with Environmental Protection Agency (EPA) sulfur regulations. A reduced expense deduction is allowed for larger businesses. For more information, see section 179B of the Internal Revenue Code.

Expensing Reforestation Costs

You can elect to deduct up to $10,000 of qualifying reforestation costs paid or incurred after October 22, 2004. The remaining costs can be amortized over an 84-month period. For more information about this deduction, see Publication 535, Business Expenses. The reforestation credit is no longer available for costs paid or incurred after October 22, 2004.

Percentage Depletion

For tax years beginning in 2004 and 2005, percentage depletion on the marginal production of oil or natural gas by independent producers and royalty owners is not limited to taxable income from the property figured without the depletion deduction. For more information, see Publication 535, Business Expenses.

Environmental Cleanup Cost Deduction

The deduction for qualified environmental cleanup costs was scheduled to expire for costs paid or incurred after December 31, 2003. This provision is extended to include costs you pay or incur before January 1, 2006. For more information about this deduction, see Publication 535, Business Expenses.

Limit on Deduction of Certain Travel, Meals, and Entertainment Expenses for Officers, Directors, or More-Than-10% Shareholders

The deduction for certain travel, meals, and entertainment expenses incurred after October 22, 2004, is limited to the amount treated as compensation to officers, directors, or more-than-10% shareholders. For more information, see section 274(e)(2) of the Internal Revenue Code.

Income Averaging for Farmers and Fishermen

If you are a fisherman, you can elect to use Schedule J to figure your 2004 tax by averaging, over the previous 3 years, all or part of your 2004 taxable income from your trade or business of fishing. Making this election may give you a lower tax if your 2004 income from fishing is high and your taxable income for one or more of the 3 prior years was low. Also, the benefit of income averaging is extended to farmers and fishermen who owe the alternative minimum tax. For more information, see the 2004 Instructions for Schedule J, Income Averaging for Farmers and Fishermen.

Income From Qualifying Shipping Activities

For tax years beginning after October 22, 2004, a corporation's gross income does not include income from qualifying shipping activities if the corporation elects to be taxed on its notional shipping income at the highest corporate tax rate (35%). See the Instructions for Forms 1120 and 1120A for more information.

Low Sulfur Diesel Fuel Credit

A new general business credit for the production of low sulfur diesel fuel is now available. It can be claimed retroactively for expenses paid or incurred after December 31, 2002. For more information, see Form 8896, Low Sulfur Diesel Fuel Production Credit.

Credit for Electricity and Refined Coal Produced From Qualified Energy

For tax years beginning after October 22, 2004, the number of qualified energy resources for purposes of this credit has been expanded. See Form 8835, Renewable Electricity and Refined Coal Production Credit, for more information.

Extension of Research Credit

The credit for increasing research activities has been extended to include research expenditures paid or incurred prior to January 1, 2006. For more information on claiming the credit, see Form 6765, Credit for Increasing Research Activities.

Work Opportunity Credit and Welfare-to-Work Credit Have Been Extended

The work opportunity credit and the welfare-to-work credit have been extended, subject to certain limitations. The credits, available to employers for part of the wages paid to certain employees, are available for employees beginning work prior to January 1, 2006. For more information, see Publication 954, Tax Incentives for Distressed Communities.

Self-Employment Tax

The self-employment tax rate on net earnings remains the same for 2004. This rate, 15.3%, is a total of 12.4% for social security (old-age, survivors, and disability insurance) and 2.9% for Medicare (hospital insurance).

The maximum amount subject to the social security part for tax years beginning in 2004 increases to $87,900. All net earnings of at least $400 are subject to the Medicare part.

2005 Changes

Section 1202 Exclusion Increased for Gain from Empowerment Zone Business Stock

A taxpayer other than a corporation generally can exclude up to 50% of a gain on the sale or trade of qualified small business stock held more than 5 years. This is called the section 1202 exclusion. Beginning in 2005, the exclusion is increased to as much as 60% of your gain if you meet the following additional requirements.

1. You sell or trade stock in a corporation that qualifies as an empowerment zone business during substantially all of the time you held the stock.
2. You acquired the stock after December 21, 2000.

Item (1) will still be met if the corporation ceased to qualify after the 5-year period that begins on the date you acquired the stock. However, the gain that qualifies for the 60% exclusion cannot be more than the gain you would have had if you had sold the stock on the date the corporation ceased to qualify.

The part of the gain that is included in income is 28% rate gain. See *Capital Gain Tax Rates* in chapter 4 of Publication 550, Investment Income and Expenses.

For more information about the section 1202 exclusion, see *Section 1202 Exclusion* in chapter 4 of Publication 550. For more information about empowerment zone businesses, see Publication 954, Tax Incentives for Distressed Communities.

Capital Gain Treatment Applies to Outright Sales of Timber

Outright sales of timber by landowners after December 31, 2004, will qualify for capital gains treatment if the timber was held for more than 1 year before the date of disposal. The new rules extending capital gains treatment for outright sales of timber are similar to certain disposals of timber under a contract with a retained economic interest. However, for outright sales, the date of disposal is not deemed to be the date timber is cut; the owner may elect to treat the payment date as the date of disposal. For more information on dispositions of timber, see Publication 544, Sales and Other Dispositions of Assets.

Deduction for Domestic Production Activities

For tax years beginning in 2005, you can deduct 3% of the smaller of:

1. Your taxable income (adjusted gross income if you are an individual) determined without regard to this deduction, or
2. Your qualified production activities income (defined later) from the following trade or business activities.
   a. Construction performed in the United States.
   b. Engineering or architectural services performed in the United States for construction projects in the United States.
   c. Any lease, rental, license, sale, exchange, or other disposition of:
      i. Tangible personal property, computer software, and sound recordings that you manufactured, produced, grew, or extracted in whole or in significant part within the United States.
      ii. Any qualified film (defined later) you produced.
      iii. Electricity, natural gas, or potable water you produced in the United States .

The deduction does not apply to income derived from the sale of food and beverages you prepare at a retail establishment; property you leased, licensed, or rented for use by any related person; or the transmission or distribution of electricity, natural gas, or potable water.

Qualified production activities income. Qualified production activities income is the excess, if any, of your gross receipts from the activities described above over the sum of:

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

When determining the cost of goods sold allocable to or the adjusted basis of leased or rented property that gives rise to your gross receipts from the activities described above, the cost or adjusted basis of any item or service brought into the United States cannot be less than its value immediately after it entered the United States. If you exported the property for further manufacture, the increase in cost or adjusted basis cannot be more than the difference between the value of the property when it was exported and the value of the property when it was brought back into the United States after the further manufacture.

Qualified film. A qualified film is any motion picture film or video tape if 50% or more of the total compensation relating to its production is compensation for services performed in the United States by actors, production personnel, directors, and producers. A qualified film does not include any property that requires records to be kept under the United States Code, title 18, section 2257, because it contains a visual depiction of sexually explicit conduct.

Limits on the deduction. The deduction cannot be more than 50% of the amount of wages (including certain elective deferrals and deferred compensation) you reported to your employees on Forms W-2. This deduction is allowed for alternative minimum tax purposes, but is not allowed in determining net earnings from self-employment.

Special rules apply to patrons of agricultural and horticultural cooperatives and members of expanded affiliated groups.

Electing S Corporation Status

For tax years beginning after December 31, 2004, the number of shareholders that an S corporation may have increases from 75 to 100.

For purposes of the 100 shareholder limit, members of a family may elect to be treated as one shareholder. The election may be made by any family member. A family is defined as the common ancestor, the lineal descendants of the common ancestor, and the spouses (or former spouses) of the lineal descendants or the common ancestor.

Increase to Withholding on Supplemental Wage Payments Exceeding $1,000,000

For payments made after 2004, the flat withholding rate on supplemental wage payments that exceed $1,000,000 during the year is increased to to 35%. See section 7 of Publication 15 (Circular E), Employer’s Tax Guide, for more information.

Employment Taxes on Employee Stock Options

Wages for social security, Medicare, and federal unemployment tax purposes do not include remuneration from exercising an incentive stock option or an employee stock purchase plan option after October 22, 2004, or from any disposition of stock acquired by exercising such an option. Federal income tax withholding is not required on income from a disqualifying disposition of stock acquired by exercising an incentive stock option or an employee stock purchase plan option after October 22, 2004, or on income from any disposition of stock acquired by exercising an employee stock purchase plan option after October 22, 2004, equal to the discount portion of stock acquired by exercising the option. See section 2 of Publication 15-B, Employer’s Tax Guide to Fringe Benefits, for more information.

Self-Employment Tax

The self-employment tax rate on net earnings remains the same for 2005. This rate, 15.3%, is a total of 12.4% for social security (old-age, survivors, and disability insurance) and 2.9% for Medicare (hospital insurance).

The maximum amount subject to the social security part for tax years beginning in 2005 has increased to $90,000. All net earnings of at least $400 are subject to the Medicare part.

Increase to FUTA Tax Deposit Requirement

The deposit threshold for FUTA tax has been increased from $100 to $500. The $500 threshold applies to FUTA tax deposits required for taxes reported on Form 940, 940-EZ, and 940-PR, Employer’s Annual Federal Unemployment (FUTA) Tax Return, for tax periods beginning after December 31, 2004.

3.

IRAs and Other Retirement Plans

2004 Changes

Individual Retirement Arrangements (IRAs)

For more information about IRAs, see Publication 590, Individual Retirement Arrangements (IRAs).

Modified AGI Limit for Traditional IRAs Increases

For 2004, if you are covered by a retirement plan at work, your deduction for contributions to a traditional IRA will be reduced (phased out) if your modified adjusted gross income (AGI) is:

- More than $65,000 but less than $75,000 for a married couple filing a joint return or a qualifying widow(er),
- More than $45,000 but less than $55,000 for a single individual or head of household, or
- Less than $10,000 for a married individual filing a separate return.

For more information, see *How Much Can You Deduct?* in chapter 1 of Publication 590.

New Method for Figuring Net Income On Returned or Recharacterized IRA Contributions

There is a new method for figuring the net income on IRA contributions made after 2003 that are returned to you or recharacterized. See *How Do You Recharacterize a Contribution?* or *Contributions Returned Before Due Date of Return* in chapter 1 of Publication 590.

For figuring the net income on IRA contributions made during 2002 and 2003 that were returned to you or recharacterized, you can use the new method described in Publication 590, the method permitted by Notice 2000-39, or the method in the proposed regulations.

Thrift Savings Plan (TSP)

Catch-up contributions. Participants in the TSP who are age 50 or older at the end of the year generally can make catch-up contributions to the plan. For 2004, the maximum catch-up contribution is $3,000. For 2005, the maximum increases to $4,000. For more information, see Publication 721, Tax Guide to U.S. Civil Service Retirement Benefits.

Qualified Plans

The following changes apply to qualified plans. For more information, see Publication 560, Retirement Plans for Small Business.

Limits on Contributions and Benefits

For 2004, the maximum annual benefit for a participant under a defined benefit plan increases to the lsmaller of the following amounts.

- 100% of the participant's average compensation for his or her highest 3 consecutive calendar years.
- $165,000.

For 2004, a defined contribution plan's maximum annual contributions and other additions (excluding earnings) to the account of a participant increases to the smaller of the following amounts.

- 100% of the compensation actually paid to the participant.
- $41,000.

Compensation Limit

For 2004, the maximum compensation used for figuring contributions and benefits increases to $205,000.

Elective Deferrals (401(k) Plans)

The limits on elective deferrals for participants in 401(k) plans and SARSEPs (excluding SIMPLE plans) are as follows.

Year	Limit
2004	$13,000
2005	14,000
2006 and later years	15,000

Note. The $15,000 limit is subject to adjustment after 2006 for cost-of-living increases.

Catch-up contributions. A plan can permit participants who are age 50 or older at the end of the calendar year to make catch-up contributions as follows.

Year	Catch-Up Limit
2004	$3,000
2005	4,000
2006 and later years	5,000

Note. The $5,000 limit is subject to adjustment after 2006 for cost-of-living increases.

The catch-up contribution a participant can make for a year cannot exceed the smaller of the following amounts.

- The catch-up contribution limit.

- The excess of the participant's compensation over the elective deferrals that are not catch-up contributions.

Simplified Employee Pensions (SEPs)

The following changes apply to SEPs. For more information, see Publication 560, Retirement Plans for Small Business.

Elective Deferral (SARSEPs) Limit

The limits on elective deferrals and catch-up contributions for participants in SARSEPs are discussed earlier under *Elective Deferrals (401(k) Plans).*

Deduction Limit Increased

The maximum deduction for contributions to a SEP remains unchanged at 25% of the compensation paid or accrued during the year to your eligible employees participating in the plan. However, for 2004, the maximum combined deduction for a participant's elective deferrals and other SEP contributions increases to $41,000.

Contribution Limit Increased

For 2004, the annual limit on the amount of employer contributions to a SEP increases to the smaller of the following amounts.

- 25% of an eligible employee's compensation.
- $41,000.

Compensation Limit

For 2004, the maximum amount of an employee's compensation you can consider when figuring SEP contributions (including elective deferrals) and the deduction for contributions increases to $205,000.

SIMPLE Plans

The following changes apply to SIMPLE plans. For more information, see Publication 560, Retirement Plans for Small Business.

Salary reduction contributions. The limit on salary reduction contributions to a SIMPLE plan is as follows.

Year	Limit
2004	$9,000
2005 and later years	10,000

Note. The $10,000 limit is subject to adjustment after 2005 for cost-of-living increases.

Catch-up contributions. A SIMPLE plan can permit participants who are age 50 or older at the end of the calendar year to make catch-up contributions as follows.

Year	Catch-Up Limit
2004	$1,500
2005	2,000
2006 and later years	2,500

Note. The $2,500 limit is subject to adjustment after 2006 for cost-of-living increases.

The catch-up contribution a participant can make for a year cannot exceed the smaller of the following amounts.

- The catch-up contribution limit.
- The excess of the participant's compensation over the salary reduction contributions that are not catch-up contributions.

403(b) Plan Changes

The following changes apply to 403(b) plans. For more information, see Publication 571, Tax-Sheltered Annuity Plans (403(b) Plans).

Increase in the limit on elective deferrals. For 2004, the limit on elective deferrals has been increased from $12,000 to $13,000. The limit on elective deferrals will increase by $1,000 each year through 2006.

Catch-up contributions. If you are age 50 or older by the end of 2004, you may be permitted to make additional catch-up contributions of up to $3,000 to your 403(b) plan.

Limit on annual additions. For 2004, the limit on annual additions has been increased from $40,000 to $41,000.

2005 Changes

Modified AGI Limit for Traditional IRAs Increases

For 2005, if you are covered by a retirement plan at work, your deduction for contributions to a traditional IRA will be reduced (phased out) if your modified adjusted gross income (AGI) is:

- More than $70,000 but less than $80,000 for a married couple filing a joint return or a qualifying widow(er),
- More than $50,000 but less than $60,000 for a single individual or head of household, or
- Less than $10,000 for a married individual filing a separate return.

Traditional IRA Contribution and Deduction Limit

The contribution limit to your traditional IRA for 2005 will be increased to the smaller of the following amounts:

- $4,000, or

- Your taxable compensation for the year.

If you are age 50 or older in 2005, the most that can be contributed to your traditional IRA for 2005 will be the smaller of the following amounts:

- $4,500, or
- Your taxable compensation for the year.

Roth IRA Contribution Limit

If contributions on your behalf are made only to Roth IRAs, your contribution limit for 2005 will generally be the lesser of:

- $4,000, or
- Your taxable compensation for the year.

If you are age 50 or older in 2005 and contributions on your behalf are made only to Roth IRAs, your contribution limit for 2005 will generally be the lesser of:

- $4,500, or
- Your taxable compensation for the year.

However, if your modified AGI is above a certain amount, your contribution limit may be reduced. For more information on Roth IRAs, see chapter 2 of Publication 590.

Qualified Plans

The following changes apply to qualified plans. For more information, see Publication 560, Retirement Plans for Small Business.

Limits on Contributions and Benefits

For years ending after 2004, the maximum annual benefit for a participant under a defined benefit plan increases to the smaller of the following amounts.

- 100% of the participant's average compensation for his or her highest 3 consecutive calendar years.
- $170,000 (subject to cost-of-living increases).

For years beginning after 2004, a defined contribution plan's maximum annual contributions and other additions (excluding earnings) to the account of a participant increases to the smaller of the following amounts.

- 100% of the compensation actually paid to the participant.
- $42,000 (subject to cost-of-living increases).

Compensation Limit

For 2005, the maximum compensation used for figuring contributions and benefits increases to $210,000.

Simplified Employee Pensions (SEPs)

The following changes apply to SEPs. For more information, see Publication 560, Retirement Plans for Small Business.

Deduction Limit Increased

The maximum deduction for contributions to a SEP remains unchanged at 25% of the compensation paid or accrued during the year to your eligible employees participating in the plan. However, for 2005, the maximum combined deduction for a participant's elective deferrals and other SEP contributions increases to $42,000.

Contribution Limit Increased

For years beginning after 2004, the annual limit on the amount of employer contributions to a SEP increases to the smaller of the following amounts.

- 25% of an eligible employee's compensation.
- $42,000 (subject to cost-of-living increases).

Compensation Limit

For years beginning after 2004, the maximum amount of an employee's compensation you can consider when figuring SEP contributions (including elective deferrals) and the deduction for contributions increases to $210,000.

403(b) Plan Changes

The following changes apply to 403(b) plans. For more information, see Publication 571, Tax-Sheltered Annuity Plans (403(b) Plans).

Increase in the limit on elective deferrals. For 2005, the limit on elective deferrals is increased from $13,000 to $14,000. The limit on elective deferrals will increase by $1,000 each year through 2006.

Catch-up contributions. If you are age 50 or older by the end of 2005, you may be permitted to make additional catch-up contributions of up to $4,000 to your 403(b) plan.

Limit on annual additions. For 2005, the limit on annual additions has been increased from $41,000 to $42,000.

For more information about 403(b) plans, see Publication 571, *Tax-Sheltered Annuity Plans (403(b) Plans)*.

4.

Exempt Organizations

2005 Changes

Acknowledgement Required for Car Donations

Qualified organizations that receive car donations after December 31, 2004, must give the donor a written acknowledgement of the donation. This rule generally applies if the claimed value of the donated vehicle is more than $500.

Boats, aircraft, and other vehicles. This rule also applies to donations of boats, aircraft, and any vehicle manufactured mainly for use on public streets, roads, and highways. However, this rule does not apply to donations of inventory.

Contents of acknowledgement. The acknowledgement must include the following information.

1. The donor's name and taxpayer identification number.
2. The vehicle identification number or similar number.
3. A statement certifying the organization sold the car in an arm's length transaction between unrelated parties.
4. The gross proceeds from the sale.
5. A statement that the donor's charitable contribution deduction may not be more than the gross proceeds from the sale.
6. The date of the contribution.

However, if there was significant intervening use of or material improvement to the car by the organization, the acknowledgement does not have to include the information in items 3, 4, and 5 above. Instead, it must contain a certification of the intended use of or material improvement to the car and the intended duration of that use and a certification that the vehicle will not be transferred in exchange for money, other property, or services before completion of that use or improvement.

This acknowledgement must be provided within 30 days of the sale of the car or, if there is significant intervening use or material improvement of the car by the organization, within 30 days of the contribution.

The organization also must provide this information to the IRS.

Penalty. There is a penalty for knowingly furnishing a false or fraudulent acknowledgement or knowingly failing to furnish a required acknowledgement in the manner, at the time, and showing the information required. For details about this penalty, see section 6720 of the Internal Revenue Code.

More information. The IRS expects to issue more guidance on this rule early in 2005. To find out if that guidance has been issued, check the Internal Revenue Bulletin or *www.irs.gov*.

5.

Estate and Gift Taxes

2004 Changes

Estate Tax Applicable Exclusion Amount Increased

An estate tax return for a U.S. citizen or resident needs to be filed only if the gross estate exceeds the applicable exclusion amount for the year of death, listed below.

Year	Exclusion Amount
2004 and 2005	$1,500,000
2006, 2007, and 2008	2,000,000
2009	3,500,000

Annual Exclusion for Gifts Increased

The annual exclusion for gifts made to spouses who are not U.S. citizens increased to $114,000.

Maximum Estate and Gift Tax Rate Reduced

For estates of decedents dying, and gifts made, after 2003, the maximum rate for the estate tax and the gift tax is as follows.

Year	Maximum Tax Rate
2004	48%
2005	47%
2006	46%
2007, 2008, and 2009	45%

Credit for State Death Taxes Reduced

For estate of decedents dying in 2004, the credit allowed for state death taxes is limited to 25% of the amount that would otherwise be allowed.

Generation-Skipping Transfer (GST) Exemption Increased

The generation-skipping transfer (GST) lifetime exemption increased to $1,500,000. The annual increase can only be allocated to transfers made during or after the year of the increase.

Qualified Family-Owned Business Interest Deduction Repealed

The qualified family-owned business interest deduction has been repealed for the estates of decedents dying after December 31, 2003.

2005 Changes

Changes to State Death Taxes

For estates of decedents dying after 2004, the credit for state death taxes will be replaced with a deduction for state death taxes.

6. Excise Taxes

Various excise tax provisions of the Internal Revenue Code were added or affected by the American Jobs Creation Act of 2004. Some of the major changes to the forms and publications are highlighted below. Explanations of the changes will be included in the next revisions of the following products:

- Form 720, Quarterly Federal Excise Tax Return, and its instructions
- Form 4136, Credit for Federal Tax Paid on Fuels
- Form 8849, Claim for Refund of Excise Taxes
- Publication 378, Fuel Tax Credits and Refunds
- Publication 510, Excise Taxes for 2005
- Form 2290/2290SP, Heavy Highway Vehicle Use Tax Return, and its instructions

Additional guidance. See Notice 2005-04, on page 289 of Internal Revenue Bulletin 2005-02, available at *www.irs.gov/pub/irs-irbs/irb05-02.pdf.*

Changes Effective for the Fourth Quarter of 2004

Vaccines

Hepatitis A is added to the list of taxable vaccines for sales after November 30, 2004. For sales made before December 1, 2004, and delivered after December 1, 2004, the delivery date is the sales date.

Bows

The 11% tax on bows will apply to bows having a peak draw weight of 30 pounds or more. This replaces the current law which applies to bows having a peak draw weight of 10 pounds or more. Broadheads suitable for use with certain arrows will be taxed as a part and accessory at the 11% bow tax rate. The effective date for both provisions is for articles sold after November 21, 2004.

Repeal of Arrow Tax

The tax on arrows that was in effect for arrows sold after November 21, 2004, and before December 23, 2004, has been repealed. The rules used prior to November 22, 2004, for arrow components still apply for the 4th quarter of 2004. Any tax that was imposed by the manufacturer, producer, or importer on arrows after November 21, 2004, and before December 23, 2004, may have to be refunded to the purchaser. See *Changes Effective for the Second Quarter of 2005* for details on the tax on arrow shafts effective after March 31, 2005.

Changes Effective for the First Quarter of 2005

Definition of Off-Highway Vehicle

New subsection 7701(a)(48) of the Internal Revenue Code provides that a vehicle with certain described features for off-highway transportation is not treated as a highway vehicle. This provision applies to taxable periods beginning after October 22, 2004.

Air Transportation Taxes

For amounts paid during 2005, the tax on the use of international air travel facilities will be $14.10 per person for flights that begin or end in the United States, or $7.00 per person for domestic segments that begin or end in Alaska or Hawaii (applies only to departures). For amounts paid for each domestic segment of taxable transportation of persons by air, the domestic segment tax is $3.20 per segment for transportation that begins in 2005.

Dyed Diesel Fuel Used in Trains

The 4.4 cents per gallon tax on dyed diesel fuel used in trains phases out. The phase out is as follows:

From	The tax per gallon is
01/01/2005 to 06/30/2005	3.4 cents
07/01/2005 to 12/31/2006	2.4 cents
01/01/2007 and later years	0.1 cents

Dyed Diesel Fuel Used in Certain Intercity or Local Buses

The reduced rate on the use of dyed diesel fuel in intercity or local buses has been eliminated. IRS No. 78 will be deleted from Form 720. Undyed diesel must be purchased at the full rate of tax. Registered ultimate vendors or the ultimate purchaser may make a claim for a refund or credit of 17 cents per gallon if certain conditions are met.

Inland Waterways Fuel Use Tax

The 24.4 cents per gallon rate on diesel fuel used in commercial transportation on inland waterways is reduced as follows:

From	The tax per gallon is
01/01/2005 to 06/30/2005	23.4 cents
07/01/2005 to 12/31/2006	22.4 cents
01/01/2007 and later years	20.1 cents

Alcohol and Biodiesel Fuels

The reduced rates for gasohol and gasoline removed for the production of gasohol (IRS Nos. 58, 59, 73, 74, 75, and 76) and the gasohol related credits and refunds are eliminated. These lines will be deleted from Form 720. Tax is imposed by Code section 4081 on gasoline, including gasoline removed for the production of gasohol and gasohol, at the full rate of 18.4 cents per gallon and is reported on Form 720.

Two new credits, the alcohol fuel mixture credit and the biodiesel mixture credit, are allowed against the amount of tax imposed on taxable fuels under section 4081.

- The alcohol fuel mixture credit is 51 cents per gallon of ethanol (60 cents per gallon for other than ethanol), and is claimed by the person producing the mixture.
- The biodiesel mixture credit is 50 cents per gallon of biodiesel ($1.00 per gallon of agri-biodiesel), and is claimed by the person producing the mixture.
- The credits must first be claimed as a credit on Schedule C (Form 720). Any excess credit may be claimed as a refund or as an income tax credit. Only one claim may be made for any particular gallon of alcohol or biodiesel.
- Persons who blend biodiesel with diesel fuel to produce a biodiesel mixture must pay the diesel fuel tax on the volume of biodiesel in the mixture. A new line will be added to Form 720 to report this tax.
- Persons who blend alcohol with gasoline to produce an alcohol fuel mixture must pay the gasoline tax on the volume of alcohol in the mixture. A new line will be added to Form 720 to report this tax.

Fishing Tackle Boxes

The rate of tax imposed on the manufacturer, producer, or importer of fishing tackle boxes (IRS No. 104) is reduced from 10% to 3%.

Electric Outboard Motors

The 3% tax imposed on the manufacturer, producer, or importer of sonar devices suitable for finding fish is repealed.

Highway-Type Tires

Tires will be taxed based on the maximum rated load capacity. The tax is 9.45 cents (4.725 cents for biasply and super single tires) for each 10 pounds over the maximum rated load capacity in excess of 3,500 pounds. A taxable tire is defined to mean any tire of the type used on highway vehicles if wholly or partially made of rubber that are marked pursuant to Federal regulations for highway use. Tires sold for the exclusive use of the Department of Defense or the Coast Guard are exempted from the tax.

Aviation-Grade Kerosene

The tax imposed by Code section 4081 on aviation fuel is repealed and replaced by a tax on aviation-grade kerosene under Code section 4081.

- The tax rate for IRS Nos. 69 and 77 will not change.
- A one month extension of time to file Form 720 for the period January 1 through March 31, 2005 (first quarter of 2005), is provided for any return reporting IRS Nos. 69 or 77. The due date is May 31, 2005, not April 30, 2005.
- There is a floor stocks tax of 21.9 cents per gallon on aviation-grade kerosene (IRS No. 114) or $.044 per gallon on aviation-grade kerosene for use in commercial aviation (IRS No. 115) held on January 1, 2005. Kerosene in the tank of an aircraft on January 1, 2005, is exempt from the floor stocks taxes. Report the tax on Form 720 for the first quarter of 2005. The due date of the return and payment date of the tax is May 31, 2005.
- Only one return is filed for the quarter. If you are reporting IRS Nos. in addition to 69, 77, 114, or 115, the return due date is May 31, 2005.

Gasoline Registered Ultimate Vendors

Gasoline registered ultimate vendors can claim a refund of gasoline sold to nonprofit educational organizations or state and local governments, instead of wholesale distributors, if certain conditions are met. Provisions related to "gasoline wholesale distributor" have been removed. Schedule 4 (Form 8849) will be eliminated. Gasoline registered ultimate vendor claims will be made on Schedule 2 (Form 8849). The claim rate will be 18.4 cents per gallon.

Change Effective for the Second Quarter of 2005

Arrow Shafts

A tax on the manufacturer, producer, or importer of arrow shafts (IRS No. 106) will apply effective after March 31, 2005. The tax is 39 cents per shaft and applies to any shaft used in the production of any arrow which after assembly measures 18 inches or more in overall length. The tax also applies to arrow shafts less than 18 inches in overall length if the arrow is suitable for use with a bow having a peak draw weight of 30 pounds or more. The tax is indexed for inflation after 2005.

Changes Effective for the Third Quarter of 2005

Vaccines

Any trivalent vaccine against influenza will be added to the list of taxable vaccines after Health and Human Services (HHS) lists the influenza vaccine for compensation from the trust fund. HHS is expected to list the vaccine in July of 2005.

Heavy Highway Vehicle Use Tax (Form 2290)

The following changes apply beginning with the period July 1, 2005, through June 30, 2006.

- The election to pay in installments has been repealed. The tax is due when the return is filed.
- Reduced rates for Mexican and Canadian vehicles have been repealed.
- Definition of off-highway vehicle has been modified by section 7701(a)(48).
- An exception from the tax applies to certain mobile machinery.

The IRS expects to issue future guidance on other provisions affecting Form 2290.

7. Foreign Issues

2004 Changes

Expatriation of Individuals

If you expatriated after June 3, 2004, the special rules for former U.S. citizens and former U.S. long-term residents have changed. Under the new rules, the process of IRS ruling requests has been eliminated. You may be subject to the expatriation rules if:

1. Your average annual net income tax liability for the 5 preceding years exceeds $124,000 (adjusted for inflation after 2004),
2. Your net worth exceeds $2 million, or
3. You fail to certify under penalties of perjury that you have complied with all U.S. federal tax obligations.

Dual citizens and certain minors who have had no substantial contact with the United States are not subject to the new rules. However, they still must provide the certification required in (3).

Under the new rules, tax-based (instead of immigration-based) rules are applied for determining when you are no longer a U.S. citizen or long-term resident for U.S. federal tax purposes. You will continue to be treated as a U.S. citizen or long-term resident for U.S. federal tax purposes until you give notice of expatriation or termination of U.S. residency to the Secretary of State or the Secretary of Homeland Security and file Form 8854 with the Internal Revenue Service. See Publication 519, U.S. Tax Guide for Aliens, for more information. At the time this publication went to print, Form 8854 was not available. When it is available, it will be posted at *www.irs.gov.*

Minimum Taxable Income Limit for Expatriated Entities and Related Persons

If a corporation is an expatriated entity or a partner in an expatriated entity, the corporation's taxable income cannot be less than its inversion gain for the tax year. For more information, see section 7874 of the Internal Revenue Code.

U.S. Possessions Income

Changes have been made to the bona fide residence and income source rules for individuals with income from U.S. possessions. Regulations will be issued that clarify the following rules. However, they were not final at the time this publication went to print. When additional guidance is issued, it will be made available on the Internet at *www.irs.gov.*

Bona fide residence. Except as provided by regulations, for tax years ending after October 22, 2004, you are a bona fide resident of a U.S. possession if, during the entire tax year, you:

- Do not have a tax home outside the possession, and
- Do not have a closer connection to the United States or to a foreign country than to the possession.

For tax years beginning after October 22, 2004 (except as provided in regulations), you must be present in the possession for at least 183 days during the tax year. If you are a calendar year taxpayer, this rule applies to your tax returns for 2005 and later years.

Reporting a change in residence. For tax years ending after October 22, 2004, and for the three preceding tax years, you must report any change to your bona fide residence in a U.S. possession. A future IRS Notice will explain the time and manner in which to report the change in residence. (This Notice was not available at the time this publication went to print.) If you do not report the change in residence, you may be charged a $1,000 penalty.

Possession source income. Except as provided in regulations, income earned after October 22, 2004, is not U.S. possession source income if it is treated as income:

- From sources within the United States, or
- Effectively connected with the conduct of a trade or business in the United States.

More information. For more information on income from U.S. possessions, see Publication 570, Tax Guide for Individuals With Income From U.S. Possessions.

Income Effectively Connected With a U.S. Trade or Business

Under certain situations, foreign-source income attributable to a U.S. office or fixed place of business is treated as effectively connected with a U.S. trade or business. This applies to rents, royalties, dividends, and interest. For tax years beginning after October 22, 2004, income equivalent to that foreign-source income that is attributable to a U.S. office or fixed place of business is also treated as effectively connected with a U.S. trade or business.

Withholding on Payments to Foreign Persons

The following changes relate to withholding on payments to foreign persons. For more information, see Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities.

- The tax rate on dividends paid after October 22, 2004, to certain corporations created or organized in, or under the law of, the Commonwealth of Puerto Rico is 10%, rather than 30%.
- For tax years beginning after October 22, 2004, a distribution by a real estate investment trust is treated as a dividend and is not subject to withholding under section 1445 as a gain from the sale or exchange of a U. S. real property interest if certain requirements are met.

Foreign Tax Credit — Taxes on Income or Gain

In general, you cannot claim a foreign tax credit for withholding tax on income or gain from certain property. This rule applies to income or gain paid or accrued after November 21, 2004. See *Foreign Taxes for Which You Cannot Take a Credit* in Publication 514, Foreign Tax Credit, for more information.

Foreign Tax Credit—Modified Carryback and Carryover Periods

Unused foreign taxes arising in tax years beginning after October 22, 2004, can be carried back only 1 year (instead of 2 years). The carryover period has been extended from 5 years to 10 years for unused foreign taxes that could, under the old rules, be carried to any tax year ending after October 22, 2004. See Publication 514, Foreign Tax Credit for Individuals, for more information.

2005 Changes

Repeal of Extraterritorial Income Exclusion

The extraterritorial income (ETI) exclusion provisions have been repealed, generally for transactions after 2004, subject to a transition rule. Under the transition rule, taxpayers may claim 80% and 60% of the otherwise-applicable pre-repeal ETI exclusion for transactions during 2005 and 2006, respectively. The general repeal of the ETI exclusion provisions does not apply to transactions in the ordinary course of a trade or business under a binding contract if such contract is between the taxpayer and an unrelated person (as defined under the ETI exclusion provisions) and such contract is in effect on September 17, 2003, and at all times thereafter.

Foreign corporations that elected to be treated as domestic corporations may, under certain circumstances, revoke such election before October 22, 2005, without recognition of gain or loss.

For more information, see the 2004 Form 8873, Extraterritorial Income Exclusion, and instructions.

Withholding on Payments to Foreign Persons

The following changes relate to withholding on payments to foreign persons. For more information, see Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities.

Dividends. The following rules apply.

- Subject to certain exceptions, no withholding is required on interest-related dividends and short-term capital gain dividends paid by a regulated investment company (RIC). This applies to dividends paid for tax years of the RIC that begin after December 31, 2004.
- For payments made after December 31, 2004, dividends paid by a foreign corporation are generally not subject to nonresident alien withholding.

U.S. real property interest. After December 31, 2004, the sale of an interest in a domestically controlled qualified investment entity is not the sale of a U.S. real property interest.

Translation of Foreign Taxes

For tax years beginning after 2004, if you claim the foreign tax credit for foreign taxes on an accrual basis and your foreign income tax liability is denominated in any currency other than your functional currency, you can elect not to translate your foreign income taxes (and any adjustments thereto) using the average exchange rate for the tax year to which the taxes relate. If you make this election, use the exchange rate in effect on the date you paid the taxes. This election is effective for the year you make it and all subsequent years unless you revoke it with IRS consent. For details, see Publication 514, Foreign Tax Credit for Individuals.

Alternative Minimum Tax Foreign Tax Credit (AMTFTC) 90% Limit Repealed

For tax years beginning after 2004, the amount of AMTFTC you can use to offset your alternative minimum tax is generally increased to 100% of your pre-credit tentative minimum tax. For tax years beginning before 2005, the amount of AMTFTC was generally limited to 90% of your pre-credit tentative minimum tax.

Residents of Japan

Beginning in 2005, if you are a nonresident alien and a resident of Japan, you generally cannot claim the following benefits. The new U.S.-Japan income tax treaty, which became effective on January 1, 2005, does not allow them.

- Exemptions for spouse and dependents.
- Qualifying widow(er) filing status.
- Single filing status for people who are married, have a child, and do not live with their spouse.

However, if you choose to have the old U.S.-Japan treaty apply in its entirety for 2005, you may be able to claim these benefits on your 2005 Form 1040NR.

8.

How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Contacting your Taxpayer Advocate. If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate independently represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate toll free at 1-877-777-4778.
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call 1-800-829-4059 if you are a TTY/TDD user.
- Visit *www.irs.gov/advocate*.

For more information, see Publication 1546, The Taxpayer Advocate Service of the IRS—How To Get Help With Unresolved Tax Problems.

Free tax services. To find out what services are available, get Publication 910, IRS Guide to Free Tax Services. It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.

Internet. You can access the IRS website 24 hours a day, 7 days a week, at *www.irs.gov* to:

- *E-file* your return. Find out about commercial tax preparation and *e-file* services available free to eligible taxpayers.
- Check the status of your 2004 refund. Click on *Where's My Refund*. Be sure to wait at least 6 weeks from the date you filed your return (3 weeks if you filed electronically). Have your 2004 tax return available because you will need to know your filing status and the exact whole dollar amount of your refund.
- Download forms, instructions, and publications.
- Order IRS products online.
- Research your tax questions online.
- Search publications online by topic or keyword.
- View Internal Revenue Bulletins (IRBs) published in the last few years.
- Figure your withholding allowances using our Form W-4 calculator.
- Sign up to receive local and national tax news by email.
- Get information on starting and operating a small business.

Fax. You can get over 100 of the most requested forms and instructions 24 hours a day, 7 days a week, by fax. Just call 703-368-9694 from the telephone connected to your fax machine. When you call, you will hear instructions on how to use the service. The items you request will be faxed to you.

For help with transmission problems, call 703-487-4608.

Long-distance charges may apply.

Phone. Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call 1-800-829-3676 to order current-year forms, instructions, and publications and prior-year forms and instructions. You should receive your order within 10 days.
- *Asking tax questions.* Call the IRS with your tax questions at 1-800-829-1040.
- *Solving problems.* You can get face-to-face help solving tax problems every business day in IRS Taxpayer Assistance Centers. An employee can explain IRS letters, request adjustments to your account, or help you set up a payment plan. Call your local Taxpayer Assistance Center for an appointment. To find the number, go to *www.irs.gov/localcontacts* or look in the phone book under *United States Government, Internal Revenue Service*.
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call 1-800-829-4059 to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call 1-800-829-4477 and press 2 to listen to pre-recorded messages covering various tax topics.
- *Refund information.* If you would like to check the status of your 2004 refund, call 1-800-829-4477 and press 1 for automated refund information or call 1-800-829-1954. Be sure to wait at least 6 weeks from the date you filed your return (3 weeks if you filed electronically). Have your 2004 tax return available because you will need to know your filing status and the exact whole dollar amount of your refund.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we use several methods to evaluate the quality of our telephone services. One method is for a second IRS representative to sometimes listen in on or record telephone calls. Another is to ask some callers to complete a short survey at the end of the call.

Walk-in. Many products and services are available on a walk-in basis.

- *Products.* You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county government offices, credit unions, and office supply stores have a collection of products available to print from a CD-ROM or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.
- *Services.* You can walk in to your local Taxpayer Assistance Center every business day to ask tax questions or get help with a tax problem. An employee can explain IRS letters, request adjustments to your account, or help you set up a payment plan. You can set up an appointment by calling your local Center and, at the prompt, leaving a message requesting Everyday Tax Solutions help. A representative will call you back within 2 business days to schedule an in-person appointment at your convenience. To find the number, go to *www.irs.gov/localcontacts* or look in the phone book under *United States Government, Internal Revenue Service*.

Mail. You can send your order for forms, instructions, and publications to the Distribution Center nearest to you and receive a response within 10 business days after your request is received. Use the address that applies to your part of the country.

- **Western part of U.S.:**
  Western Area Distribution Center
  Rancho Cordova, CA 95743-0001
- **Central part of U.S.:**
  Central Area Distribution Center
  P.O. Box 8903
  Bloomington, IL 61702-8903
- **Eastern part of U.S. and foreign addresses:**
  Eastern Area Distribution Center
  P.O. Box 85074
  Richmond, VA 23261-5074

CD-ROM for tax products. You can order Publication 1796, IRS Federal Tax Products CD-ROM, and obtain:

- Current-year forms, instructions, and publications.
- Prior-year forms and instructions.
- Frequently requested tax forms that may be filled in electronically, printed out for submission, or saved for recordkeeping.
- Internal Revenue Bulletins.

Buy the CD-ROM from National Technical Information Service (NTIS) at *www.irs.gov/cdorders* for $22 (no handling fee) or call 1-877-233-6767 toll free to buy the CD-ROM for $22 (plus a $5 handling fee). The first release is available in early January and the final release is available in late February.

CD-ROM for small businesses. Publication 3207, The Small Business Resource Guide, CD-ROM 2004, is a must for every small business owner or any taxpayer about to start a business. This handy, interactive CD contains all the business tax forms, instructions, and publications needed to successfully manage a business. In addition, the CD provides other helpful information, such as how to prepare a business plan, finding financing for your business, and much more. The design of the CD makes finding information easy and quick and incorporates file formats and browsers that can be run on virtually any desktop or laptop computer.

It is available in early April. You can get a free copy by calling 1-800-829-3676 or by visiting *www.irs.gov/smallbiz*.

Index

To help us develop a more useful index, please let us know if you have ideas for index entries. See "Comments and Suggestions" in the "Introduction" for the ways you can reach us.

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