Happy Holiday and Prosperous New Year
From Cho Chan and Staff

Tax Letter

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Dear clients and friends:

In October 2004, Congress passed the 2004 American Jobs Creation Act (hereinafter referred to as the "Jobs Act"). Within the "Jobs Act", there lies a great number of income tax related sections. Among them, section 102(a) of the "Jobs Act" created a new Internal Revenue Code provision. This new provision is IRC section 199. The purpose of IRC section 199 is to help promo American production and encourage American companies to keep their productions at home by offering them a very special **tax deduction**. How successful this can be remains to be seen. Our theme is to explain in **general terms** the special tax deduction, however.

Overall, this special tax deduction will be a **specified percentage** of the "**qualified production activities income**", in short the "**gross profit**" derived from "**qualified production activities**" in the U.S. Therefore, we need to understand what is "**qualified production activities**" ?

"**Qualified production activities**" are defined very broadly and loosely. They refer to nearly any business or commercial activities including selling, exchanging, leasing, renting and even licensing any of the "**qualified production properties** ". By "**qualified production properties**" the tax code refers to nearly all goods and services resulted from domestic production, manufacturing, growing, extraction and generation. These include all types of manufactured tangible products, agricultural products, sound records, certain film productions, electricity, natural gas and computer software; but specifically exclude any and all distribution, transportation and transmission type activities whether performed in relation to or independent of. Further, retailing of food and beverages are also specifically excluded.

Interestingly enough that the special tax deduction also applies to the gross profit from Construction in the U.S. for the erection or substantial renovation of residential and commercial buildings and infrastructure. Engineering and architectural services performed in the U.S. for U.S. construction projects are also included.

To calculate the **special deduction, we must first calculate** the "**qualified production activities income**" or for short, the "**gross profit**". "Gross profit" is the result of all the gross receipts/revenue derived from the "qualified production activities" **Minus** all directly related costs and expenses, and further **Minus** certain required allocation of related but indirect expenditures. If the "taxable income" is less than the "**gross profit**", then, use the taxable income.

[For instruction regarding related but indirect expenditures required to be allocated as part of costs and expenses, please refer to IRC section 199(c)(1)(B)(iii)].

At the end, the "gross profit" will be **multiplied** by a specified percentage, and the percentages specified by the tax code are as follows:

(a) For years 2005 and 2006 ---------- three percent (3%)
(b) For years from 2007 to 2009 -------- six percent (6%)
(c) 2010 and thereafter ---------------- nine percent (9%)

For example, your 2005 "gross profit" from qualified activities is $100,000. Your special deduction will be $3,000 ($3% of $100,000). The same $100,000 "gross profit" in 2010, your special deduction will be $9,000 (9% of $100,000).

We understand that the above discussion is a general explanation and an overview of a complex "Domestic Production Deduction", therefore, if you wish to further discuss the subject matter, please contact us at 415-381-0681 or visit our website at **www.chochan.com**.

Seasons Greeting,

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