President Signs Extenders And Omnibus Acts, Impacting Broad Range Of Provisions

Just before recessing for the holidays, the House and Senate passed the Protecting Americans from Tax Hikes Act of 2015 (PATH Act). President Obama signed the Act and a FY 2016 omnibus on December 18. The Act does considerably more than the typical tax extenders legislation seen in prior years. It makes permanent over 20 key tax provisions, including the research tax credit, enhanced Code Sec. 179 expensing, and the American Opportunity Tax Credit. It also extends other provisions, including bonus depreciation, for five years; and revives many others for two years. In addition, many extenders have been enhanced. Further, Act imposes a two-year moratorium on the ACA medical device excise tax. The House passed the Act on December 17 by a vote of 318-109; The Senate approved the Act along with the FY 2016 omnibus on December 18 by a vote of 65 to 33.

IMPACT. Eleventh-hour negotiations between the White House and Congressional Republicans reached agreement on a “major” tax bill, the first significant tax legislation since passage of the American Tax Relief Act of 2012 (ATRA). The tax measures in the Act are expansive and impact nearly all individuals and businesses, across all sectors of the economy. The Protecting Americans from Tax Hikes Act of 2015 may be the last major tax bill of the Obama administration.

COMMENT. In past years, the IRS has cautioned that late tax legislation could delay the start of the filing season. At the time this Briefing was prepared, the IRS had not indicated if late passage of tax legislation would delay the 2016 filing season.

EXTENDERS FOR INDIVIDUALS

The Act extends permanently many popular but heretofore temporary tax incentives for individuals. It also modifies some of them, as well as extending the rest, for either five or two years, retroactive to the start of 2015.

IMPACT. This year’s extenders law does much more than just deal with extensions, permanent or otherwise. It contains numerous other provisions that impact tax administration, “family tax relief,” real estate investment trusts, and more.

Omnibus. In an omnibus fiscal year (FY) 2016 budget bill, lawmakers approved delaying for two years the ACA excise tax on so-called “Cadillac” health insurance plans and imposing a one-year moratorium on the ACA health insurance provider fee. Lawmakers also voted to raise the IRS’s FY 2016 budget. The House approved the FY 2016 omnibus on December 18 by a vote of 316 to 113.
**Permanent Extensions for Individuals**

The Act makes several key individual extenders permanent.

**State and Local Sales Tax Deduction**

The election to claim an itemized deduction for state and local general sales taxes, in lieu of deducting state and local income taxes, expired after December 31, 2014. The Act makes the election permanent.

**IMPACT.** In addition to this provision being particularly valuable to taxpayers in states without an income tax, some taxpayers who make a big ticket purchase, such as a motor vehicle, before year-end could benefit by weighing the deduction for state and local general sales taxes against their deduction for state and local income taxes.

**American Opportunity Tax Credit**

The Act makes permanent the American Opportunity Tax Credit (AOTC), an enhanced version of the Hope education credit. The AOTC has been available at an increased level of $2,500, with adjusted gross income (AGI) phase-out amounts of $80,000 (single) and $160,000 (married filing jointly). The AOTC had been scheduled to expire after 2017.

**IMPACT.** Under the Act, the child tax credit, available up to $1,000 for qualifying dependents under age 17, may be refundable to the extent of 15 percent of the taxpayer’s earned income in excess of $3,000.

**Child Tax Credit**

The Act makes permanent the reduced earned income threshold amount of an unindexed $3,000. This provision had been scheduled to expire after 2017.

**IMPACT.** The Act also makes permanent the increased 45 percent credit percentage for taxpayers with three or more qualifying children. Under prior law, both enhancements had been available only through 2017.

**Teachers’ Classroom Expense Deduction**

The Act permanently extends the above-the-line deduction for elementary and secondary–school teachers’ classroom expenses. It also modifies the deduction by indexing the $250 ceiling amount to inflation beginning in 2016. Additionally, the Act includes “professional development expenses” within the scope of the deduction.

**Charitable Distributions from IRAs**

The Act permanently extends the provision for individuals age 70 1/2 and older to be allowed to make tax-free distributions from individual retirement accounts (IRAs) to a qualified charitable organization. The treatment continues to be capped at a maximum of $100,000 per taxpayer each year.

**IMPACT.** Amounts in excess of $100,000 must be included in income but may be taken as an itemized charitable deduction, subject to the usual AGI annual caps for contributions.

**Comment.** The Act also includes a provision on the deductibility of charitable contributions to agricultural research organizations.

**Qualified Conservation Contributions**

A special rule allows contributions of capital gain real property for conservation purposes, with the contribution to be taken against 50 percent of the contribution base. Under the Act, this special rule is permanently extended. It is also modified for Alaska Native Corporations.

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"Eleventh-hour negotiations between the White House and Congressional Republicans reached agreement on a ‘major’ tax bill, the first significant tax legislation since passage of the American Tax Relief Act of 2012 (ATRA)."
Tax Briefing
December 18, 2015

Two-Year Extensions for Individuals

The Act renews several extenders related to individuals, for two years through 2016.

IMPACT. Because of their retroactive application to the start of 2015, two-year provisions will be up for renewal again at the end of 2016.

Qualified Tuition/Related-Expenses Deduction

The Act extends through 2016 the above-the-line deduction for qualified tuition and fees for post-secondary education.

Mortgage Debt Exclusion

The Act excludes from income cancellation of mortgage debt on a principal residence of up to $2 million ($1 million for a married taxpayer filing a separate return) through 2016. The Act also modifies the exclusion to apply to qualified principal residence indebtedness discharged in 2017 if discharge is made under a binding written agreement entered into in 2016.

IMPACT. Without an extension, debt that is forgiven through a foreclosure, short sale or loan modification could be treated as taxable income if another exclusion, such as for insolvency, is not available.

Mortgage Insurance Premium Deduction

This measure treats mortgage insurance premiums as deductible interest that is qualified residence interest subject to AGI phase-out. The Act extends this special treatment through 2016.

EXTENDERS FOR BUSINESSES

Included in the Act are a host of business tax incentives, with some major provisions being made permanent (including the research credit and Code Sec. 179 expensing) or extended for five years (including bonus depreciation), as well as modified. Others have been extended for two years through 2016.

Permanent Extensions for Businesses

The Act makes permanent many business-related provisions that had been up for renewal.

Code Sec. 179 Expensing

Pre-Act, the dollar limit for Code Sec. 179 expensing for 2015 had reverted to $25,000 ($1 million for a married taxpayer filing a separate return) through 2016. The Act permanently sets the Code Sec. 179 expensing limit at $500,000 with a $2 million overall investment limit before phase out (both amounts indexed for inflation beginning in 2016).

IMPACT. The Act also makes permanent the special Code Sec. 179 expensing for qualified real property. The Act also removes the $250,000 cap related to this category of expenditure beginning in 2016. Some businesses may want to postpone larger purchases of such property until 2016 as a result.

Research Tax Credit

The research and development (R&D) tax credit is available to taxpayers with specified increases in business-related qualified research expenditures and for increases in payments to universities and other qualified organizations for basic research. The Act permanently extends the credit.

IMPACT. Although used primarily by large businesses, the credit is available to small businesses, especially of potential value in the technology sector. The Act allows qualified small businesses to claim the credit against AMT liability and qualified startups to claim a portion of the credit against their employer FICA liability.

COMMENT. Many businesses had complained that research investment requires years to realize potential and short extensions of the research credit were counterproductive.

100-Percent Gain Exclusion on Qualified Small Business Stock

The 100-percent exclusion allowed for gain on the sale or exchange of qualified small business stock held for more than five years by non-corporate taxpayers is made permanent.

IMPACT. This benefit has proven a valuable method of funding certain startups. With a five-year holding period, it obviously still requires a long-term commitment. Trading such stock for other, similar stock, however, can be a useful option under which gain is allowed to be deferred.

PATH ACT AS PART OF TAX REFORM AGENDA

“I think this is one of the biggest steps toward a rewrite of our tax code that we have made in many years, and it will help us start a pro-growth bold tax reform agenda in 2016. In addition to all of that, we are ending Washington’s days of extending tax policies one year at a time.”

-- House Speaker Paul Ryan, R-Wis., on December 16.
Reduced Recognition Period For S Corporation Built-In Gains Tax

The Act makes permanent the five-year recognition period for built-in gain following conversion from a C to an S corporation.

**IMPACT.** A corporate-level tax, at the highest marginal rate applicable to corporations (currently, 35 percent), is imposed on an S corporation’s net recognized built-in gain (for example, gain that arose prior to the conversion of the C corporation to an S corporation and is recognized by the S corporation during the recognition period).

Other Permanent Business Extenders

The Act also extends permanently and in some cases modifies:

- 15-year straight-line cost recovery for qualified leasehold improvements, restaurant property and retail improvements
- Employer wage credit for employees who are active duty members of the uniformed services
- Treatment of certain dividends of regulated investment companies (RICs)
- The subpart F exception for active financing income
- Charitable deductions for the contribution of food inventory
- Tax treatment of certain payments to controlling exempt organizations
- Basis adjustment in stock when an S corporation makes charitable contributions of property
- Minimum low-income housing tax credit for non-federally subsidized buildings
- Military housing allowance exclusion in determining a low-income tenant
- RIC qualified investment entity treatment under FIRPTA

**Five-Year Extensions for Businesses**

The Act makes several business-related provisions available for five-years, under the rationale that, although they should not be made permanent, they are sufficiently valuable at this time to be relied upon for more than the usual two-year extenders period.

**Bonus Depreciation**

The Act extends bonus depreciation (additional first-year depreciation) under a phase-down schedule through 2019:

- at 50 percent for 2015-2017;
- at 40 percent in 2018; and
- at 30 percent in 2019.

The Act also continues the election to accelerate the use of AMT credits in lieu of bonus depreciation and increases the amount of unused AMT credits that may be claimed in lieu of bonus depreciation. Additionally, the Act modifies bonus depreciation to include qualified improvement property, and permits certain trees, vines and plants bearing fruits or nuts to be eligible for bonus depreciation when planted or grafted.

**COMMENT.** Certain longer-lived and transportation property may qualify for an additional one-year placed in service date.

**COMMENT.** Also related, bonus depreciation is modified to be adjusted for inflation in computing the first-year depreciation for passenger autos.

**IMPACT.** Unlike Code Sec. 179 expensing (above), only new property is eligible for bonus depreciation.

**Work Opportunity Tax Credit**

The Work Opportunity Tax Credit (WOTC) is extended through 2019. The Act also enhances the WOTC for employers that hire certain long-term unemployed individuals.

**New Markets Tax Credit**

The Act authorizes the allocation of $3.5 billion of new markets tax credits for each year from 2015 through 2019.

**Look-thru Treatment for CFCs**

The Act extends through 2019 the look-through treatment for payments of dividends, interest, rents, and royalties between related controlled foreign corporations under the foreign personal holding company rules.

**More Two-Year Business Extenders**

The Act extends, and in some cases modifies, through 2016:

- Indian employment credit/accelerated depreciation
- Railroad track maintenance credit
- Empowerment zones incentives
- Film/television expensing
- Mine rescue team training credit
- Election to expense mine safety equipment
- Qualified Zone Academy Bonds

### COST OF SELECTED EXTENDERS*

<table>
<thead>
<tr>
<th>Extender</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Research Tax Credit</td>
<td>$113.24 billion</td>
</tr>
<tr>
<td>State And Local Sales Tax Deduction</td>
<td>$42.44 billion</td>
</tr>
<tr>
<td>Section 179 Expensing</td>
<td>$77.01 billion</td>
</tr>
<tr>
<td>Refundable Child Credit</td>
<td>$87.8 billion</td>
</tr>
<tr>
<td>Bonus Depreciation</td>
<td>$28.2 billion</td>
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<tr>
<td>Subpart F Exception for Active Financing Income</td>
<td>$78.00 billion</td>
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<tr>
<td>Mortgage Debt Forgiveness</td>
<td>$5.14 billion</td>
</tr>
<tr>
<td>Tuition And Fees Deduction</td>
<td>$608 million</td>
</tr>
</tbody>
</table>

* cost over 10 years
The Act delays for two years the ACA excise tax on high-dollar health care plans, known as “Cadillac” plans. The Act also provides that payments of the tax will be deductible against income tax.

**Affordable Care Act**

The Act and the FY 2016 omnibus affect several provisions under the ACA.

**“Cadillac” plans.** The Act delays for two years the ACA excise tax on high-dollar health care plans, known as “Cadillac” plans. The Act also provides that payments of the tax will be deductible against income tax.

**Energy-Efficient Commercial Buildings Deduction**

The Act extends through 2016 the deduction for energy-efficient commercial buildings. Additionally, the Act updates the energy-efficient standards.

**Production Credit for Indian Coal Facilities**

The Act extends through 2016 the production credit for qualified Indian coal facilities. The Act removes certain limitations and allows the credit to be claimed against the AMT.

**More Energy Extenders**

Also extended by the Act through 2016 are:

- Credit for alternative fuel refueling property
- Credit for 2-wheel plug-in electric vehicles
- Second generation biofuel producer credit
- Biodiesel and renewable diesel incentives
- Credit for energy-efficient new homes
- Special allowance for second generation biofuel plant property
- Special rules for sales/dispositions to implement FERC
- Excise credits for alternative fuels.

**MISCELLANEOUS PROVISIONS**

The main focus of the Protecting Americans from Tax Hikes Act of 2015 involves the over-50 temporary provisions known collectively as “Tax Extenders.” However, the Act contains many more measures unrelated to extension of those provisions. Over 80 non-extender-related sections of the Act cover a broad spectrum of miscellaneous tax provisions. Highlights of some of these provisions include the following changes.

**Code Sec. 529 Plans**

Under the Act, the purchase of computer equipment and technology with a distribution from a Code Sec. 529 plan is permanently considered a qualified expense. The Act also removes certain distribution aggregation requirements and allows the redeposit of 529 funds without penalty in certain circumstances when tuition is refunded.
ABLE Accounts

The Act allows for amounts from 529 accounts to be rolled over to an ABLE account penalty-free, subject to certain limitations. The Act also removes the prior law requirement that ABLE accounts may be established only in the state of residence of the ABLE account owner.

Partnerships

The Act makes some technical corrections and clarifications to the revision of partnership audit rules in the Bipartisan Budget Act of 2015. Of particular note is a new Code Sec. 6225(c)(5) that governs “specified passive activity loss” of partners in certain publicly traded partnerships.

Timber Gains

Effective for tax year 2016, the Act provides that C corporation timber gains are subject to a tax rate of 23.8 percent.

Employee Plans

Included in the Act are several provisions affecting employee plans.

SIMPLE plans. Under the Act, qualified individuals may generally roll over amounts from an employer-sponsored retirement plan to a SIMPLE IRA.

IRAs. The Act includes technical amendments to prior legislation related to amounts received in certain bankruptcies by qualified airline employees and rolled over.

Retirement distributions. The Act clarifies the treatment of early retirement distributions for nuclear materials couriers, United States Capitol Police, Supreme Court Police, and diplomatic security special agents.

EXEMPT ORGANIZATIONS

Included in the Act are several provisions impacting exempt organizations.

Code Sec. 501(c)(4) organizations. The Act repeals the current application process for Code Sec. 501(c)(4) organizations. In its place, the Act provides for a streamlined recognition process for organizations seeking 501(c)(4) status.

COMMENT. The FY 2016 omnibus prohibits the IRS from issuing, revising or finalizing any guidance on determining whether an organization is operated exclusively for the promotion of social welfare for purposes of Code Sec. 501(c)(4).

Adverse determinations. Under the Act, the IRS is directed to create procedures for Code Sec. 501(c) organizations, facing adverse determinations, to seek administrative appeal in IRS Appeals. The provision is retroactive to determinations made after May 19, 2014. Further, the Act allows Code Sec. 501(c)(4) organizations and other exempt organizations to seek judicial review of any revocation of exempt status.

Gift tax. The Act clarifies that transfers to certain exempt organizations, such as civic leagues, labor or agricultural organizations, or business leagues under Section 501(c)(4), (5) or (6), are exempt from federal gift tax.

REITs

Included in the Act are provisions modifying and clarifying the tax rules for real estate investment trusts (REITs). Many are designed to curb the aggressive use of REIT-rules as a corporate tax-reduction strategy.

Spin-offs. Under the Act, a spin-off involving a REIT qualifies as tax-free only if immediately after the distribution both the distributing and controlled corporation are REITs. Following a tax-free spin-off transaction, neither a distributing nor a controlled corporation will be allowed to elect to be treated as a REIT for 10 years.

Dividends. The Act places limits on designations of dividends by REITs. The aggregate amount of dividends designated by a REIT as qualified dividends or capital gains dividends will not exceed the dividends actually paid by the REIT. Additionally, the

ADDITIONAL PROVISIONS – MORE THAN JUST EXTENDERS

Although the PATH Act’s main impact involves changes to the over-50 “Tax Extenders,” the Act contains over 80 non-extender-related tax provisions under a number of catch-all headings:

- “Program Integrity” (including safeguards surrounding ITINs, information returns, and restrictions regarding retroactive claims of education incentives, use of the child credit, and earned income credit, among others);
- “Family Tax Relief” (including exclusions under the Work College Program, improvements to Section 529 accounts, and rollovers into simple retirement accounts, among others);
- “Real Estate Investment Trusts” (including restrictions on tax-free spinoffs, limitations on designation of dividends, hedging provisions, and over a dozen other REIT-related provision);
- “Tax Administration” (including rules for IRS employees, truncated Social Security Numbers for Form W-2, clarification of enrolled agent credentials, and tweaks to the new partnership audit rules, among others); and
- “U.S. Tax Court” (including taxpayer access to the Tax Court along with additional rules and clarifications).
Act repeals the preferential dividend rule for publicly offered REITs.

Earnings and profits. Under the Act, current (but not accumulated) REIT earnings and profits for any tax year are not reduced by any amount that is not allowable in computing taxable income for the tax year and was not allowable in computing its taxable income for any prior tax year.

Services. The Act provides that a taxable REIT subsidiary is permitted to operate foreclosed real property without causing income from the property to fail to satisfy the REIT income tests

More REIT provisions. The Act also:

- Treats debt instruments of publicly offered REITs and mortgages as real estate assets
- Addresses fixed percentage rent and interest exceptions for REIT income tests
- Provides alternative safe-harbor for determining percentage of assets a REIT may sell annually
- Clarifies asset/income tests regarding certain ancillary personal property
- Expands the treatment of REIT hedges
- Provides the IRS with authority for alternative remedies to address certain REIT distribution failures
- Clarifies the treatment of certain services provided by taxable REIT subsidiaries
- Provides various clarifications under the FIRPTA for REITs

IRS ADMINISTRATION AND BUDGET

The Act makes a number of changes to rules for IRS employees and the FY 2016 omnibus provides spending authority.

Taxpayer rights. The Act codifies the IRS’s Taxpayer Bill of Rights. The Act also authorizes taxpayers whose information has been wrongly disclosed, to ascertain certain facts about the disclosures.

IRS personnel. The Act prohibits IRS employees from using personal email for official business. The Act also provides for termination of employment where employees perform, delay or fail to perform work to benefit a political purpose.

IRS budget. The FY 2016 omnibus appropriates $11,235 billion for funding of IRS operations. That represents an increase of $290 million compared to FY 2015 spending.

IMPACT. Lawmakers directed the IRS to use the additional funding to make “measurable improvements in the customer service” as well as improve the identification and prevention of refund fraud and identity theft, and enhance cyber security.

Other Measures. Additionally, in addressing tax administrative matters, the Act:

- Revises the requirements for ITINs
- Clarifies higher education information reporting
- Clarifies the treatment of certain credits for purposes of certain penalties
- Revises procedures to reduce improper claims
- Modifies tax collection periods for members of the Armed Forces hospitalized because of combat zone injuries
- Includes restrictions on taxpayers who improperly claimed credits in prior years
- Increases the penalty for paid preparers engaging in reckless/willful conduct
- Extends IRS authority to require truncated Social Security numbers on Form W–2.
- Clarifies enrolled agent (EA) designation.

REVENUE PROVISIONS

The Act includes a number of provisions treated as “revenue” measures. The Act provides for:

- Updated standards for energy efficient commercial buildings deduction
- Excise tax credit equivalency for liquefied petroleum gas and liquefied natural gas
- Exclusion from gross income of certain petroleum gas and liquefied natural gas
- Clarification of valuation rule for early termination of certain charitable remainder unitrusts
- Prevention of transfer of certain losses from tax indifferent parties
- Treatment of certain persons as employers with respect to motion picture projects.

IMPACT. Despite these revenue provisions, the PATH Act shows a net revenue loss in the amount of $622 billion.