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New PATH Act Makes Many Tax Extenders Permanent

OVERVIEW

New legislation enacted on December 18, 2015, entitled the Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act"), retroactively reinstates for 2015 over 50 favorable tax "extenders" that previously expired at the end of 2014. "Extenders" are temporary tax provisions that are routinely extended by Congress on a one- or two-year basis. Unlike previous tax extender legislation, the PATH Act permanently renews a wide range of tax breaks for individuals and small businesses. These permanent extensions will facilitate tax planning by eliminating the uncertainty of whether these provisions would be extended from year to year.

TAX PLANNING POINTS:

1. There is also a possibility that carried interest may be affected by proposed laws. This will likely have little or no effect on our current family office (VFO, MFO and SFO) planning, but will certainly impact fund managers and private equity managers. Consequently, any contemplated transfers of carry for gift and estate tax purposes should be accelerated for those managers.

2. The Act enhances investment in US real estate and REITs. The law is generally pro taxpayer. The major changes include the availability of foreign pension funds to invest without being subject to FIRPTA withholding. This does not change the need for blocker entities in planning for such investments.

3. The Act also allows a publicly traded REIT to presume that a person holding less than 5 percent of such class of stock at all times during the testing period is a US person absent actual knowledge to the contrary. This eliminates withholding and related paperwork. There are many minor changes affecting REITs which are positive in most cases; however, the FIRPTA withholding rate was increased to 15% from 10% for dispositions of US real estate.

4. While increasing the income exemption limit from $1.2M to $2.2M per year for captive insurance companies, the new rules also greatly limit the number of businesses and taxpayers that can use captives. This will effectively limit a major risk management and potential income tax deferral strategy for many small, medium and privately-held businesses. Consequently, your captive structures and operations should be reviewed this year.

The key PATH Act provisions and changes are set forth below:

Tax Extenders under the PATH Act of 2015						
PERMANENTLY EXTENDED	**Qualified Charitable Distributions**	**American Opportunity Credit**	**State & Local Sales Tax Deduction**	**Enhanced Child Tax Credit**	**Section 179 Expensing**	
RENEWED	**50% Bonus Depreciation**	**Work Opportunity Credit**	**Discharge of Mortgage Debt**	**Deductiblity of Mortgage Insurance Premiums**	**Qualified Tuition & Expenses Deduction**	**529 Account Provisions**

PERMANENTLY EXTENDED

Qualified Charitable Distribution

The PATH tax extenders make the Qualified Charitable Distribution ("QCD") rules, first enacted in 2006 and last expired in 2014, permanent at the prior threshold of $100,000 per tax year.[1] Taxpayers who are age 70 ½ or older are now permanently permitted to make a QCD of up to $100,000 directly from an Individual Retirement Account (“IRA”) to a “qualified” charity. Qualified charities include public charities but not donor advised funds or private foundations. The QCD is not deductible as a contribution to the charity, but it is excluded from the taxpayer’s income. An exclusion can be even better than a deduction for taxpayers with deduction limits or subject to the Alternative Minimum Tax. The contribution *does* count toward the taxpayer’s required minimum distribution. There are procedural rules to be followed to be sure the QCD achieves the desired results and avoids treatment as a taxable distribution.

American Opportunity Tax Credit

College students are now eligible for a $2,500 American Opportunity Tax Credit per year for up to four years of post-secondary education tuition and related expenses.[2] Under the PATH Act, the Adjusted Gross Income (“AGI”) phaseout levels were also raised to $160,000 for married couples and $80,000 for individuals. This permanent change may come as a pleasant surprise, as this credit was scheduled to lapse in 2017 and revert back to the old Hope Scholarship Credit that only allowed for an $1,800 credit for the first two years of post-secondary education tuition and related education expenses.

Itemized Deduction for State and Local Sales Tax

Taxpayers are permanently allowed to claim an itemized deduction for either the payment during the year of either state income taxes or state sales taxes under the new PATH tax extenders.[3] Taxpayers should claim whichever amount is higher to produce the largest deduction. Typically, state and local sales tax is only claimed by those who live in states without any income tax such as Florida, Texas, Nevada, South Dakota, Alaska, Washington and Wyoming.

Enhanced Child Tax Credit

The new PATH tax extenders make the $3,000 threshold permanent for calculating the additional refundable portion of the Child Tax Credit.[4] The Child Tax Credit is a $1,000 credit available to taxpayers with “qualifying children” in their household who are claimed as a dependent and who do not provide more than half of their own support. This credit phases out when AGI reaches $110,000 for married couples and $75,000 for individuals. However, for low-income taxpayers, who do not even have a $1,000 tax liability, the credit becomes a refundable credit called the Additional Child Tax Credit for 15 percent of earned income over a threshold amount.

Section 179 Expensing Limitations

Section 179 is used when a taxpayer purchases property for use in a trade or business.[5] Typically, taxpayers cannot deduct the amount paid for the property at once, but must instead take depreciation deductions over the span of several years. In some circumstances, the taxpayer can elect to deduct capital expenditures on certain “qualified” property on a year-to-year basis, up to a certain dollar amount in that current tax year. Previously, this amount was $250,000 until 2010 when the amount was increased to $500,000 until 2014 when this amount expired. If the PATH Act had not extended the amount to $500,000 permanently, this amount would have dropped to only $25,000 in 2015 due to the pre-existing phaseout of the Section 179 rules.

Additionally, the $2,000,000 threshold amount for phasing out the deduction if more than a certain amount of property is placed in service during the year has been made permanent. This threshold was set to decrease to $200,000 in 2015 before the PATH Act was passed.

Both of these permanent extenders also index the $500,000 and $2,000,000 amounts for inflation beginning in 2016.

Section 1202 Sale of Small Business Stock Capital Gain Exclusion

If a taxpayer holds “qualified” small business stock for more than five years, the taxpayer can exclude from his or her income a certain percentage of the capital gain on the sale of the stock, subject to certain limitations.[6] This percentage has been changed several times by Congress and was set to return to 25 percent in 2015, but has finally been made permanent at 100 percent. Additionally, the rules that eliminate such capital gain as an Alternative Minimum Tax (“AMT”) preference item are also made permanent for 2015 and all future years, allowing the favorable treatment to be preserved even for those subject to the AMT.

EXTENDED THROUGH 2019

Bonus Depreciation

As detailed above, if a taxpayer purchases a property for use in a trade or business, the taxpayer generally cannot deduct the purchase price at once and must capitalize the cost and take depreciation deductions over several years. Under a special “bonus depreciation” rule and subject to certain requirements, the depreciation deduction for the first year when the property was placed in service was 50 percent of the purchase price.[7] This percentage expired in 2014 but has been extended through 2017. In 2018, the bonus depreciation rule will continue but only as a 40 percent bonus, and in 2019 it will be reduced to 30 percent. This 50 percent bonus depreciation is in addition to the Section 179 deduction described above.

Work Opportunity Credit

The Work Opportunity Tax Credit has been extended through 2019 for any business that hires certain targeted groups, including veterans and long-term unemployed individuals who have been unemployed for more than 27 weeks. This credit can be up to $9,600.

EXTENDED THROUGH 2016

Discharge of Qualified Principal Place of Residence Debt

Under general tax rules, debt that is discharged by the lender results in taxable income to the taxpayer.[8] Several exceptions to this general rule exist, such as excluding debt from taxable income that was discharged due to mortgage issues. This exception expired at the end of 2014, but the PATH extenders now provide relief for taxpayers who had debt discharged on a mortgage due to a restructuring, foreclosure or short sale through 2016. The PATH Act also modifies the exception to apply to qualified

principal residence indebtedness that is discharged in 2017 pursuant to a written agreement entered into in 2016.

Deductibility of Mortgage Insurance Premiums

Current law permits taxpayers who pay mortgage insurance premiums (e.g. private mortgage insurance or reverse mortgage insurance) to deduct the premiums as if it were interest on mortgage debt provided that the mortgage was taken out after 2006 and was acquisition debt from the primary residence. The PATH extenders allow taxpayers to deduct these premiums through the end of 2016. If a taxpayer's AGI exceeds $100,000, the deduction begins to phase out and is fully phased out at an AGI of $110,000.

Qualified Tuition and Educational Expenses

Until the end of 2016, a taxpayer who meets specific requirements can deduct up to $4,000 of tuition and related educational expenses paid when enrolled in a qualified post-secondary institution if their AGI does not exceed $65,000 individually or $130,000 if married filing jointly. If the taxpayer's AGI exceeds this amount, they may still be eligible for a $2,000 deduction. This deduction is an "above-the-line deduction," which means that the taxpayer can benefit even if they do not itemize. Parents can also claim this deduction if they paid fees on behalf of a dependent child.

529 Accounts

The PATH Act also contains a provision that, although not an extender, benefits 529 college savings plans. Beginning for the 2015 tax year, the definition of qualified higher education expenses for which tax-preferred distributions from 529 accounts are eligible was changed to include computer equipment, software and related services if the equipment, software or services are to be used primarily by the beneficiary during any of the years the beneficiary is enrolled in an eligible education institution.

Additionally, when determining the tax consequences of a distribution or multiple distributions from a 529 plan, the PATH Act repeals the rule that required all 529 accounts be aggregated and allows distributions to be computed on a distribution-by-distribution basis. Lastly, refunds of tuition paid with amounts distributed from a 529 account are now treated as a qualified expense beginning in the 2015 tax year if such amounts are re-contributed to a 529 account within sixty days.

CONCLUSION

Please contact us at (312) 641-2100 if you would like Handler Thayer, LLP to aid you in your future tax planning due to the new PATH Act tax extenders.

[1] I.R.C. § 408(d)(8).

[2] I.R.C. § 25(A).

[3] I.R.C. § 164(b)(5).

[4] I.R.C. § 24.

[5] I.R.C. § 179.

[6] I.R.C. § 1202.

[7] I.R.C. § 168(k).

[8] I.R.C. § 108(a)(1)(E).

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