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Dear Client and Friends:

This year, the last minute extender legislation passed as part of the Consolidated Appropriations Act, 2016 (the Act) contains good news for just about everyone. It makes many of the long-favored tax breaks (so-called extenders) permanent and retroactively extends (some for five years, others for two years) the rest of them, and, for the cherry on top, it throws in a few new tax breaks as well. In fact, about the only downside is that the retroactive extension for 2015 leaves precious little time to take advantage of the tax breaks for this year, but not for future years. Taxpayers will finally be able to determine with relative certainty (as much as there is certainty with taxes) the impact of these tax provisions on their long-term financial and business planning decisions. Here is a quick summary of the most important tax changes.

Family and Individual Tax Breaks

Tax Breaks Made Permanent. The Act makes a whole slew of favored individual provisions permanent, including the following:

- *Deduction of State and Local General Sales Taxes.* For the last few years, individuals who paid little or no state income taxes had the option of claiming an alternative itemized deduction for state and local sales taxes. The sales tax deduction option expired at the end of 2014, but the Act makes this option permanent starting in 2015, so that itemizers can elect to deduct state and local sales taxes instead of state and local income taxes for tax years beginning in 2015 and beyond.

- *IRA Qualified Charitable Contributions.* For 2006–2014, IRA owners who had reached age 70½ were allowed to make tax-free charitable contributions of up to $100,000 directly out of their IRAs. Such contributions were called Qualified Charitable Distributions (QCDs), and they counted as IRA Required Minimum Distributions (RMDs). Charitably inclined seniors with more IRA money than they needed could reduce their income tax bills by arranging for tax-free QCDs to take the place of taxable RMDs. This break expired at the end of 2014. The Act makes this tax break permanent so that it's available for QCDs made in tax years 2015 and beyond.

- *$250 Deduction for K-12 Educators.* For the last few years, teachers and other eligible personnel at K-12 schools could deduct up to $250 of school-related expenses paid out of their own pockets—whether they itemized or not. This break expired at the end of 2014. The Act makes this deduction permanent so that it is allowed for 2015 and beyond. Also, beginning in 2016, the $250 cap will be indexed for inflation and professional development expenses will be deductible under this provision.

- *Qualified Conservation Contribution Breaks.* Qualified conservation contributions are charitable donations of real property interests, including remainder interests and easements that restrict the use of real property. Liberalized deduction rules applied through 2014 that increased the maximum write-off for these contributions. The Act makes these liberalized rules permanent.

- *100% Gain Exclusion for Qualified Small Business Corporation (QSBC) Stock.* The Act retroactively restores and makes permanent the 100% gain exclusion (within limits) and the exception from alternative minimum tax preference treatment for sales of QSBC stock that expired at the end of 2014. Note that you must hold QSBC shares for more than five years to be eligible for the 100% gain exclusion.

- *American Opportunity Tax Credit (AOTC).* The AOTC is a credit of $2,500 for various tuition and related expenses for the first four years of post-secondary education. It phases out for AGI starting at $80,000 (if single) and $160,000 (if married filing jointly). This break was set to expire after 2017. The Act makes the AOTC permanent.

- *Parity for Employer-provided Transit and Parking Benefits.* The Act retroactively restores and makes permanent the parity provision that requires the tax exclusion for transit benefits to be the same as the exclusion for parking benefits. Thus, for 2015, employees can receive tax-free transit benefits of up to $250 a month—the same as for tax-free parking benefits.

- *Favorable Rule for S Corporation Donations of Appreciated Assets.* The Act retroactively restores and makes permanent the favorable shareholder basis rule for stock in S corporations that make charitable donations of appreciated assets. For such donations, each shareholder's tax basis in the S corporation's stock is only reduced by the shareholder's prorata percentage of the company's tax basis in the donated assets. Without this tax break, a shareholder's basis reduction would equal the passed-through write-off for the donation (a larger amount). The provision is taxpayer-friendly because it leaves shareholders with higher tax basis in their S corporation shares.

Credits for Qualified Solar Electric and Water Heating Property Extended through 2021. The 30% credit for qualified solar water heating property and solar electric property expenditures was scheduled to expire for property placed in service after 2016. The Act extends this credit through 2021. For property placed in service in calendar-years 2017—2019, the credit remains at 30%. The credit is reduced to 26% or property placed in service in calendar-year 2020 and 22% for property placed in service in calendar-year 2021.

Tax Breaks Extended through 2016. Individual tax breaks that weren't made permanent or extended through 2021 by the Act, were extended for two years through 2016, including the following:

- *Tax-free Treatment for Forgiven Principal Residence Mortgage Debt.* For federal income tax purposes, a forgiven debt generally counts as taxable Cancellation of Debt (COD) income. However, a temporary exception applied to COD income from cancelled mortgage debt that was used to acquire a principal residence. Under the temporary rule, up to $2 million of COD income from principal residence acquisition debt that was cancelled in 2007–2014 was treated as a tax-free item. The Act retroactively extends this break to cover eligible debt cancellations that occur before 2017 or are pursuant to a written agreement entered into before 2017.

- *Mortgage Insurance Premium Deduction.* Premiums for qualified mortgage insurance on debt to acquire, construct, or improve a first or second residence can potentially be treated as deductible qualified residence interest. The deduction is phased out for higher-income taxpayers. Before the Act, this break wasn't available for premiums paid after 2014. The Act retroactively extends the break for premiums paid before 2017.

- *Qualified Tuition Deduction.* This write-off, which can be as much as $4,000 or $2,000 for higher-income folks, expired at the end of 2014. The Act retroactively extends it through 2016.

- *$500 Energy-efficient Home Improvement Credit.* In past years, taxpayers could claim a tax credit of up to $500 for certain energy-saving improvements to a principal residence. The credit equals 10% of eligible costs for energy-efficient insulation, windows, doors, and roof, plus 100% of eligible costs for energy-efficient heating and cooling equipment, subject to a $500 lifetime cap. This break expired at the end of 2014, but the Act retroactively extends it for two years, to apply to property placed in service before 2017.

New Tax Breaks. The Act also includes a number of new individual tax breaks, including:

- Allowing tax-preferred distributions from 529 accounts to be spent computer equipment and technology.

- Allowing ABLE accounts (tax-preferred savings accounts for disabled individuals), which currently may be located only in the state of residence of the beneficiary, to be established in any state. This will allow individuals setting up ABLE accounts to choose the state program that best fits their needs, such as with regard to investment options, fees, and account limits.

- **A**llowing a taxpayer to roll over distributions from an employer-sponsored retirement plan [e.g., a 401(k) plan] and traditional IRA (that is not a SIMPLE IRA) to a SIMPLE IRA, provided the SIMPLE IRA has existed for at least two years.

Cost Recovery Provisions

Enhanced Section 179 Deduction Made Permanent. The Act retroactively restores and makes permanent the (1) enhanced maximum Section 179 deduction of $500,000 (same as in effect from 2010 through 2014), (2) enhanced Section 179 deduction phase-out threshold of $2 million (same as in effect from 2010 through 2014), and (3) rule allowing Section 179 deductions for qualified real property. Without this change, the maximum Section 179 deduction was scheduled to be only $25,000, the phase-out threshold was scheduled to fall to $200,000, and there was to be no Section 179 deduction privilege for real estate.

Additionally, for tax years beginning after 2015, (1) the $500,000 and $2 million limits will be indexed for inflation, (2) the special $250,000 deduction cap that previously applied to qualified real property will be eliminated, and (3) air conditioning and heating units will be eligible for expensing.

15-year Depreciation for Certain Real Property Improvements Made Permanent. The Act retroactively extends and makes permanent the 15-year straight-line depreciation privilege for qualified leasehold improvements, qualified restaurant property, and qualified retail space improvements.

Bonus Depreciation Extended through 2019. The Act retroactively extends bonus depreciation for qualifying new (not used) assets that are placed in service during 2015 through 2019 (2020 for certain assets with longer production periods). The bonus depreciation percentage is 50% for property placed in service during 2015 through 2017 (2018 for certain assets with longer production periods) and phases down to 40% for property placed in service in 2018 (2019 for certain assets with longer production periods), and 30% for property placed in service in 2019 (2020 for certain assets with longer production periods).

For new passenger autos and light trucks subject to the luxury auto depreciation limitations, the bonus depreciation increases the maximum first-year depreciation deduction by $8,000 for vehicles placed in service through 2017, $6,400 for vehicles placed in service in 2018, and $4,800 for vehicles placed in service in 2019.

Other Business Tax Breaks

Tax Breaks Made Permanent. Business provisions made permanent by the Act, include the following:

- *Research and Development (R&D) Credit.* The Act retroactively and permanently extends the R&D credit. Additionally, beginning in 2016, eligible small businesses ($50 million or less in gross receipts) may claim the credit against Alternative Minimum Tax (AMT), and the credit can be utilized by certain small businesses against the employer's payroll tax (i.e., FICA) liability.

- *Break for S Corporation Built-in Gains.* When a C corporation converts to S corporation status, the corporate-level Section 1374 built-in gains tax generally applies when built-in gain assets (including receivables and inventories) are turned into cash or sold within the *recognition period*. The tax is only assessed on built-in gains (excess of FMV over basis) that exist on the conversion date. The *recognition period* is normally the 10-year period that begins on the conversion date. However, for S corporation tax years beginning in 2012 through 2014, the recognition period was five years. The Act makes the five-year recognition period permanent retroactive to tax years beginning in 2015. In other words, for gains recognized in 2015 and beyond, the built-in gains tax won't apply if the fifth year of the recognition period has gone by before the start of the year.

- *Differential Pay Credit for Small Employers.* The Act retroactively and permanently extends the credit for eligible small employers that provide differential pay to employees while they serve in the military. The credit equals 20% of differential pay of up to $20,000 paid to each qualifying employee during the tax year. Additionally, beginning in 2016, the Act modifies the credit to apply to employers of any size, rather than employers with 50 or fewer employees, as under current law.

Work Opportunity Credit (WOTC) Hiring Deadline Extended through 2019. The Act retroactively extends the general deadline for employing eligible individuals for purposes of claiming the WOTC to cover qualifying hires who begin to work before 2020. With respect to individuals who begin work for an employer after 2015, the PATH Act also modifies the WOTC to apply to employers who hire qualified long-term unemployed individuals (i.e., those who have been unemployed for 27 weeks or more) with the credit with respect to such long-term unemployed individuals equal to 40% of the first $6,000 of wages.

Tax Breaks Extended through 2016. The following business tax breaks were retroactively extended for two years through 2016:

- *Credit for Building Energy-efficient Homes.* The Act retroactively extends the $2,000 or $1,000 (depending on the projected level of fuel consumption) per-home contractor tax credit for building new energy-efficient homes in the U.S. to qualifying homes sold by December 31, 2016, for use as a residence.

- *Energy-efficient Commercial Building Property Deduction.* The Act retroactively extends the deduction for the cost of an "energy efficient commercial building property" placed in service during the tax year for two years, for property placed in service before 2017. The maximum deduction for any building for any tax year is the excess (if any) of the product of $1.80, and the square footage of the building, over the total amount of the Section 179 deductions claimed for the building for all earlier tax years.

New Rules for Information Reporting

Accelerated Due Date for Reporting Employee and Nonemployee Compensation. Currently, a business that pays nonemployee compensation totaling $600 or more in any tax year to a single payee must file a Form 1099-MISC (Miscellaneous Income) with the IRS by the last day of February of the year following the calendar year to which such returns relate (or March 31 if filed electronically). Similarly, employers must file Form W-2, Wage and Tax Statement, to report wage paid to employees with the Social Security Administration (SSA) by that same date.

The Act accelerates the date that Forms 1099-MISC and W-2 must be filed with the IRS and SSA. Starting with 2016 Forms 1099-MISC and W-2 filed in 2017, the returns must be filed with the IRS (or SSA) by January 31 of the year following the calendar year to which such returns relate and they are no longer eligible for the extended March 31 filing date for electronically filed returns.

Penalty Relief for *De Minimis* Errors on Information Returns. Substantial penalties can apply for failing to file correct information returns and to furnish correct information to payees. The penalties are the same regardless of the size of the error in the amount reported. For returns required to be filed after 2016, the Act establishes a new safe harbor from penalties if the return is otherwise correctly filed but includes only a *de minimis* error of $100 or less ($25 or less in the case of errors involving tax withholding). In this case, the issuer is not required to file a corrected return and no penalty is imposed, unless the recipient of such the incorrect return requests a corrected return.

Healthcare Excise Taxes Delayed

The Act delays the imposition following healthcare excise taxes:

- *Medical Device Tax.* The Act provides a two-year moratorium on the 2.3% excise tax imposed on the sale of medical devices. The tax will not apply to sales during calendar-years 2016 and 2017.

- *Cadillac Tax.* A 40% excise tax imposed on high-cost employer sponsored health coverage (often referred to as the Cadillac tax) was scheduled to take effect for tax years beginning after 2017. The Act delays the tax for two years. It will now be imposed for tax years beginning after 2019. The Act also makes this tax a deductible business expense.

Conclusion

As you can see, the tax extender legislation includes lots of tax changes and not all of them were extender provisions. We did not cover them all here because we did not want this to turn into a book. If you have questions or want more complete information, please contact us.