Wolters Kluwer CCH

Tax Increase Prevention Act of 2014/ ABLE Act/Omnibus Funding Agreement

December 16, 2014 — Special Report

HIGHLIGHTS

- Over 50 Extenders
- More Than 500 Code Changes
- State And Local Sales Tax Deduction Extended
- Mortgage Debt Forgiveness Exclusion Extended
- 50 Percent Bonus Depreciation Extended
- Research Tax Credit Available For 2014
- Many Energy Incentives Renewed
- Tax-Favored Accounts For Individuals With Disabilities
- Inflation-Adjustments For Civil Penalties
- FY 2015 Budget Cut For IRS

INSIDE

Congress Passes Extenders Package, ABLE Act; Cuts IRS Budget

In a flurry of year-end activity, Congress has approved the Tax Increase Prevention Act of 2014 (HR 5771). The new law extends the so-called "tax extenders" retroactively for one year (through 2014). It also includes the Achieving a Better Life Experience (ABLE) Act, creating tax-favored savings accounts for individuals with disabilities along with some tax-related offsets. Before adjourning, Congress also approved an Omnibus Spending Agreement for fiscal year (FY) 2015, which cuts funding for the IRS. President Obama has indicated that he will sign both the Omnibus Agreement and H.R. 5771 bills as soon as they reach his desk.

IMPACT *The one-year retroactive extension of the tax extenders effectively allows taxpayers to claim the popular but temporary incentives on their 2014 returns filed in 2015. Without this, individuals would be unable to claim, for example, the state and local sales tax deduction, higher education tuition deduction, and the exclusion for discharge of mortgage debt. Business and energy incentives, most notably the research tax credit, bonus depreciation and the production tax credit, would otherwise be unavailable.*

IMPACT *In the weeks before passage, there were discussions of making permanent a number of extenders, especially the research tax credit and some charitable giving incentives. The Tax Increase Prevention Act does not make permanent any of the extenders –nor extends any of them for the usual two-year period customary for most recent extenders legislation. Instead, the new law punts the ultimate fate of the extenders for the 2015 tax year and beyond to the 114th Congress.*

IMPACT *The extenders package appears to have been passed sufficiently early to give the IRS adequate time to reprogram its return processing systems for the new law. Previously, IRS Commissioner John Koskinen warned that late legislation would likely delay the start of the filing season. Koskinen recently indicated that mid-December passage of the extenders would be workable for the IRS.*

INDIVIDUAL EXTENDERS

The Tax Increase Prevention Act renews the individual extenders through 2014. These extenders include:

State And Local Sales Tax Deduction

After December 31, 2013, the election to claim an itemized deduction for state and local general sales taxes in lieu of state and local income taxes expired. The extenders package extends the election through 2014.

IMPACT *The election is not only potentially beneficial to taxpayers in states without an income tax. 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.*

COMMENT *As in past years, the IRS is expected to release Optional State Sales Tax Tables for 2014 to shortcut taxpayers' need to use the actual receipts method.*

Higher Education Deduction

The higher education deduction allows taxpayers to deduct – above-the-line – qualified tuition and fees for post-secondary education. The extenders package extends the deduction through 2014.

IMPACT *The maximum deduction is $4,000 for taxpayers with AGI not exceeding $65,000 ($130,000 for a joint return), $2,000 for taxpayers with AGI $65,000--$80,000 ($130,000--$160,000 for joint filers) and $0 for other taxpayers. Under regulations, expenses paid by year-end for an academic term starting on or before March 31 of the following year qualify for the deduction in the year paid.*

Teachers' Classroom Expense Deduction

The teachers' classroom expense deduction allows primary and secondary education professionals (grades K-12, including school administrators and assistants) to deduct – above-the-line – qualified expenses up to $250 paid out-of-pocket during the year. Qualified expenses must be reduced by any reimbursements from the taxpayer's employer. The extenders package extends the teachers' classroom expense deduction through 2014.

IMPACT. *Substantiation for qualified expenses remains a requirement. Expenses beyond the $250 limit may be deducted as an itemized deduction only, subject to the overall 2 percent adjusted gross income floor on miscellaneous itemized deductions.*

Mortgage Debt Exclusion

Unless excluded, cancellation of indebtedness income is included in income. The Tax Increase Prevention Act of 2014 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 2014.

IMPACT *Without an extension, debt that is forgiven in 2014 through a foreclosure, short sale or loan modification could be treated as taxable income. The existing insolvency exclusion, as well as an exclusion when mortgage debt is considered nonrecourse, continues to remain available.*

Mortgage Insurance Premium Deduction

This provision in the extenders package treats mortgage insurance premiums as deductible interest that is qualified residence interest subject to AGI phaseout. The extenders package extends this special treatment through 2014.

> "The Tax Increase Prevention Act does not make permanent any of the extenders and punts the ultimate fate of the extenders to the 114th Congress..."

Charitable Distributions From IRAs

Individuals age 70 1/2 and older will continue to be allowed to make tax-free distributions from individual retirement accounts (IRAs) to a qualified charitable organization. The treatment is capped at a maximum of $100,000 per taxpayer each year. This incentive is now extended through 2014.

IMPACT *If a taxpayer is married and files a joint income tax return, his or her spouse can also have a qualified deduction and exclude up to $100,000. 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.*

Transit Benefits Parity

The Tax Increase Prevention Act of 2014 extends "transit benefits parity" through 2014. This extension provides that the income exclusion for employer-provided mass-transit and parking benefits will remain on equal footing for 2014: at $250/month.

IMPACT *Parity will become an immediate issue again in 2015 when, under the law, mass-transit pre-tax benefits will be capped at $130 and parking at $250 (as adjusted for inflation).*

COMMENT *After the most recent extension of transit benefits parity (for 2012 and 2013), the IRS provided special rules for application of the retroactive increase in excludable transit benefits. In certain cases, employers could make adjustments on their Form 941, Employer's Quarterly Federal Tax Return. The IRS is expected to provide similar relief for 2014.*

Contribution Of Real Property For Conservation Purposes

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. The extenders package extends this special rule through 2014.

BUSINESS EXTENDERS

The Tax Increase Prevention Act extends many business tax incentives for one year retroactively to January 1, 2014. These extenders include:

Bonus Depreciation

Bonus depreciation allows taxpayers to claim an additional first-year depreciation deduction. The Tax Increase Prevention Act of 2014 extends 50-percent bonus depreciation through 2014 (through 2015 for certain property with a longer production period and certain aircraft).

IMPACT *Qualified property must be depreciable under the Modified Accelerated Cost Recovery System (MACRS) and have a recovery period of 20 years or less. Property must be new and placed in service before January 1, 2015 (January 1, 2016 for certain longer production period property and certain aircraft).*

IMPACT *The extension of 50-percent bonus depreciation effectively results in an $8,000 increase in first year depreciation caps for vehicles purchased in 2014. As a result of this extender, the luxury auto depreciation limit under Code Sec. 280F for passenger automobiles placed in service in 2014 is now $11,160 (rather than only an inflation-adjusted $3,160); and for trucks and vans first placed in service during the 2014 calendar year, it is now $11,460 (rather than only $3,460) for 2014.*

COMMENT *Taxpayers claim bonus depreciation in the tax year that a qualifying asset in placed in service. This may not necessarily be the same tax year that the asset is acquired. Only new property is eligible for bonus depreciation.*

IMPACT *The extenders package also extends the election to accelerate the use of AMT credits in lieu of bonus depreciation.*

Code Sec. 179 Expensing

Enhanced Code Sec. 179 allows taxpayers to immediately deduct, rather than gradually depreciate, the cost of qualified assets, subject to certain limitations. The extenders package sets the Code Sec. 179 dollar limit at $500,000 for 2014 with a $2 million overall investment limit.

IMPACT *Absent Congressional action, the dollar limit for Code Sec. 179 expensing was $25,000 for 2014 with an investment limit of $200,000. Code Sec. 179 expensing has been at the $500,000/$2 million level since 2010. It returns to the $25,000/$200,000 level in 2015 without further action by Congress.*

IMPACT *The Tax Increase Prevention Act of 2014 also extends through 2014 the special rule allowing off-the-shelf computer software to be treated as Code Sec. 179 property.*

Qualified Leasehold/Retail Improvements, Restaurant Property

Qualified leasehold improvements, qualified retail improvements and qualified restaurant property may be treated as Code Sec. 179 property, but with a lower dollar cap. The extenders package extends this treatment through 2014.

IMPACT *Under the extenders package, taxpayers may elect to treat up to $250,000 of qualified leasehold/retail improvement, restaurant property as Code Sec. 179 property.*

Research Tax Credit

The research tax credit may be claimed for increases in business-related qualified research expenditures and for increases in payments to universities and other qualified organizations for basic research. The Tax Increase Prevention Act of 2014 extends the research tax credit through 2014.

IMPACT *The research credit generally allows taxpayers a 20-percent credit for qualified research expenses or a 14 percent alternative simplified credit. Although there had been last-minute discussions of enhancing the credit, the extenders package contains no enhancements, leaving them to the 114th Congress.*

COMMENT *The research tax credit was identified as one key incentive to be made permanent in the failed House-Senate negotiations in November. As in past negotiations, the cost of a permanent credit emerged as one of the greatest stumbling blocks.*

Work Opportunity Tax Credit

Employers that hire military veterans and other qualified individuals may be eligible for the Work Opportunity Tax Credit (WOTC). The credit amount is generally equal to 40 percent of up to $6,000 (higher for some veterans) in qualified first-year wages. The Tax Increase Prevention Act of 2014 extends the WOTC through 2014, for employees who begin work for the employer before January 1, 2015.

100-Percent Exclusion For Gain 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 has been extended for one more year, applicable to stock acquired before January 1, 2015.

IMPACT *Stock acquired after 2014 will be entitled to only a regular 50 percent exclusion if not extended again by Congress.*

COST OF SELECTED EXTENDERS*

Research Tax Credit	$7.629 billion
Mortgage Debt Forgiveness	$3.143 billion
State And Local Sales Tax Deduction	$3.142 billion
15-Year Recovery Leasehold/Retail Improvement, Restaurant Property	$2.382 billion
Work Opportunity Tax Credit	$1.375 billion
Incentives For Biodiesel And Renewable Diesel	$1.297 billion
Code Sec. 25C Residential Energy Credit	$832 million
Tuition And Fees Deduction	$300 million
Source: Joint Committee on Taxation, December 3, 2014 *cost over 10 years ($81.369 billion cost in 2015); $41.599 billion over 10 years)	

Reduced Recognition Period For S Corporation Built-In Gains Tax

The Tax Increase Prevention Act of 2014 extends to sales of assets occurring during 2014, the five-year recognition period for built-in gain following conversion from a C to an S corporation. The period, normally 10 years, generally begins with the first day of the first tax year for which the corporation is 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).*

More Business Extenders

A lengthy list of other business extenders expired after 2013. The Tax Increase Prevention Act of 2014 includes one-year, retroactive extensions for 2014 dealing with the:

- New Markets Tax Credit;
- Employer wage credit for activated military reservists;
- Subpart F exceptions for active financing income;
- Look through rule for related controlled foreign corporation payments;
- Railroad track maintenance credit;
- Classification of certain race horses as three-year property;
- Seven-year recovery period for motorsports entertainment complexes;
- Enhanced deduction for charitable contributions of food inventory;
- Tax incentives for empowerment zones;
- Indian employment credit;
- Accelerated depreciation for business property on Indian reservations;
- Special expensing rules for qualified film and television productions;
- Mine rescue team training credit;
- Election to expense advanced mine safety equipment;
- Qualified zone academy bonds;
- Low-income tax credits for non-federally subsidized new buildings;
- Low-income housing tax credit treatment of military housing allowances;
- Treatment of dividends of regulated investment companies (RICs);
- Treatment of RICs as qualified investment entities;
- S corporations making charitable donations of property;
- Puerto Rico domestic production activities deduction;
- Cover over of rum excise taxes; and
- Economic development credit for American Samoa.

COMMENT *The extenders package also increases the threshold for the Joint Committee on Taxation's mandatory review of C corporation refund claims from $2 million to $5 million.*

Multiemployer Pension Plans

"Division D" of the Tax Increase Prevention Act includes special provisions for multiemployer pension plans. Generally, multiemployer pension plans will continue to be able to take an additional five years to amortize funding shortfalls. This extension would otherwise expire at the end of 2014. The Act also extends special rules for three categories of severely underfunded multiemployer plans. Both provisions are extended through 2015.

SOME EXTENDERS NOT EXTENDED

The Tax Increase Prevention Act does not extend:
- Plug-in Electric Vehicle Credit
- Energy-Efficient Appliance Credit
- Placed-In-Service Date For Partial Expensing Of Certain Refinery Property
- New York Liberty Zone Tax-Exempt Bond Financing
- Health coverage credit for displaced workers

ENERGY EXTENDERS

Incentives for energy conservation and the production of alternative fuels expired after 2013. The Tax Increase Prevention Act of 2014 extends the following incentives through 2014:

Code Sec. 25C Credit

The Code Sec. 25C nonbusiness energy property credit rewards taxpayers who make qualified energy efficiency improvements to residential property. The Tax Increase Prevention Act of 2014 extends the Code Sec. 25C credit through 2014.

IMPACT *Examples of qualified Code Sec. 25C property are improvements such as adding insulation, energy efficient exterior windows and energy efficient heating and air conditioning systems.*

Production Tax Credit

The production tax credit (PTC) provides a per-kilowatt-hour tax credit for electricity generated by qualified energy resources and sold by the taxpayer to an unrelated person. The Tax Increase Prevention Act of 2014 extends the PTC through 2014.

Biodiesel And Renewable Diesel

The Tax Increase Prevention Act of 2014 extends through 2014 the production credit for biodiesel and the production credit for diesel fuel from biomass. The small agri-biodiesel producer credit is also extended.

More Energy Extenders

Other energy incentives extended by the Tax Increase Prevention Act of 2014 include:

- Second generation biofuel producer credit;
- Production credit for Indian coal facilities;
- Credit for energy-efficient new homes;
- Second generation biofuel plant property;
- Deduction for energy-efficient commercial buildings;
- Special rules for sales of electric transmission property;

- Excise tax credits for alternative fuels; and
- Credit for alternative fuel vehicle refueling property.

TECHNICAL CORRECTIONS

Technical corrections are corrections to the text of laws necessary to ensure that the laws are implemented as intended. The Tax Increase Prevention Act of 2014 makes technical corrections to, among other laws, the American Taxpayer Relief Act of 2012 (ATRA), the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, the American Recovery and Reinvestment Act of 2009, and the Economic Stimulus Act of 2008.

ABLE ACT

The Achieving a Better Life Experience (ABLE) Act ("Division B" of the Tax Increase Prevention Act of 2014 (HR 5771)) creates tax-favored savings accounts for individuals with disabilities for tax years beginning after December 31, 2014. The ABLE Act authorizes states to create an ABLE Program (similar to Code Sec. 529 college savings programs).

IMPACT *Qualified distributions include amounts used to cover medical expenses as well as costs of education, transportation and housing. Distributions used for nonqualified expenses would be subject to income tax on the portion of the distributions attributable to earnings from the account, plus a 10 percent penalty.*

IMPACT *Individuals with disabilities would be limited to one ABLE account; and total annual contributions by all individuals to any one ABLE account could be made up to the gift tax exclusion amount. For 2015, the gift tax exclusion amount is $14,000.*

529 Plans

The ABLE Act also authorizes investment direction for Code Sec. 529 plans by an account contributor or designated beneficiary up to two times each year. The change is effective for tax years beginning after December 31, 2014.

OFFSETS

The ABLE Act contains a number of tax-related offsets, as well as offsets related to Medicare and workers' compensation (The extenders portion of the new law by agreement is not offset by any tax increases.) The ABLE Act offset provisions include:

Professional Employer Organizations

The ABLE Act authorizes the IRS to certify qualifying professional employer organizations (PEOs), which would allow the PEO to become solely responsible for the customer's employment taxes. The ABLE Act requires the IRS to establish a PEO certification program by July 1, 2015 with a $1,000 annual user fee to participate.

Dividends From CFCs

The ABLE Act excludes dividends received from a controlled foreign corporation from the definition of personal holding company income. This treatment is effective for tax years ending on or after the date of enactment.

Penalties

Effective for returns filed after December 31, 2014, the ABLE Act indexes for inflation certain civil tax penalties. They include penalties under Code Sec. 6651 for failure to file a tax return or to pay tax; Code Sec. 6652(c) failure to file certain information returns, registration statements, and certain other statements; Code Sec. 6695 failure of a paid preparer to meet certain obligations; Code Sec. 6698 failure of a partnership to file a return; Code Sec. 6699 failure of S corporation to file a return; and Code Sec. 6721(f)(1) failure to file correct information returns and payee statements.

Levy

The ABLE Act increases the IRS levy authority on payments to Medicare providers to collect unpaid taxes. The change is effective for levies issued six months after enactment.

Inland Waterways Excise Tax

The inland waterways fuel excise tax funds the Inland Waterways Trust Fund. The ABLE Act increases the excise tax to 29 cents per gallon.

FY 2015 IRS BUDGET

Just before adjourning, Congress approved a FY 2015 Omnibus Funding Agreement for the federal government. The Omnibus agreement, within its $1.1 trillion package, funds the IRS at $10.945 billion for FY 2015, which is $346 million less than FY 2014 funding.

IMPACT *IRS Commissioner John Koskinen has cautioned that reduced funding will be reflected in further cuts to customer service and enforcement. The Omnibus agreement specifically instructs the IRS to improve its 1-800 helpline and enhance response times.*

COMMENT *The Omnibus agreement directs the IRS to submit quarterly reports to Congress concerning advance payments of the Code Sec. 36B premium assistance tax credit, accelerate help for victims of identity theft, intensify its scrutiny of payroll service providers, and address fraud and filing errors in refundable credit programs. Additionally, the Omnibus agreement directs the IRS to report to Congress on its policy for the payment of bonuses to employees, update lawmakers about the Free File Program and the Taxpayer Assistance Blueprint, and identify assistance for rural taxpayers.*

COMMENT *The Omnibus agreement extends a limited prohibition on certain corporate inverters that move their corporate "residences" offshore from contracting with the federal government, as well as extending the internet sales tax ban for one additional year. The Omnibus agreement also amends the rules for multiemployer pension plans to allow some struggling plans to reduce benefits to current retirees and exempts expatriate health plans from the Affordable Care Act.*