Newly Enacted "Protecting Americans from Tax Hikes Act of 2015" Has Broad Impact on Individuals and Small Businesses

Laurence E. Fundler

Greenbaum, Rowe, Smith & Davis LLP Client Alert

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In the seasonal spirit of giving and just before recessing for the holidays, Congress took action in the form of numerous tax relief provisions by passing the Protecting Americans from Tax Hikes Act of 2015 (PATH), signed into law by President Obama on December 18, 2015.

The new law retroactively reinstates and extends a range of individual and small business tax planning provisions that had previously expired at the end of 2014. In addition, PATH makes permanent over 20 key tax provisions. The passing of PATH protects important tax savings measures and provides more certainty to tax provisions for both individuals and small businesses.

Key provisions of PATH providing *permanent extensions for individuals* include:

- **Distributions from IRAs to Charities**: The provision permitting tax-free qualifying charitable distributions directly from IRAs, which previously expired at the end of 2014, has been extended and made permanent. The provision applies to an individual age 70 ½ and older and the benefit continues to be capped at $100,000.

- **Itemized Deduction for Sales Tax**: The election to claim an itemized deduction for state and local sales taxes, rather than deducting state and local income taxes, which election expired after December 31, 2014, has been reinstated and made permanent. This provision is particularly valuable to taxpayers in states without income tax however it may also be valuable to any taxpayers who made a significant purchase during the year.

- **Contributions of Conservation Easements**: The qualified conservation contributions deduction, which expired at the end of 2014, has been renewed and made permanent. A charitable gift of a conservation easement is deductible to the extent of 50% (100% for "qualified" farmers or ranchers) of adjusted gross income, and any excess can be carried forward for up to 15 years.

Key provisions of PATH providing *two year extensions for individuals* include:

- **Discharge of Qualified Principal Residence Indebtedness**: The exclusion of discharged mortgage debt on a qualified principal residence, which had expired after December 31, 2014, has been extended through 2016. The provision excludes from income the cancelation of mortgage debt on a principal residence up to $2,000,000. It also modifies the exclusion to apply to qualified principal residence indebtedness that is discharged in 2017, if the discharge is pursuant to a written agreement entered into in 2016.

- **Qualified Tuition and Related Educational Expenses**: The above-the-line education deduction for qualified tuition and fees, up to $4,000, has been extended through 2016. Under this provision, if you meet certain requirements, you can deduct up to $4,000 of “qualified tuition and related expenses” paid for enrollment in a qualified post-secondary school, if your AGI doesn't exceed $65,000 ($130,000 if you're married and file jointly). If your AGI exceeds that limit but doesn't exceed $80,000 ($160,000 if you're married and file jointly), you may be eligible to claim up to $2,000 of qualified higher education expenses.

Key provisions of PATH providing *permanent extensions for businesses* include:

- **Section 179 Expense Limitation**: The Code section 179 expensing limits on the purchase of property for use in a trade or business, previously set at $500,000 with a $2,000,000 investment limit before phase-out, and which expired at the end of 2014, has been extended and made permanent. Both amounts are indexed for inflation beginning in 2016.

- **Research Credit**: A credit against federal income tax for certain qualified expenditures made for research, which expired for amounts paid or incurred after December 31, 2014, has been made permanent. In addition, the credit amount has been increased from 14% to 20%.

- **Sale of Qualified Small Business Stock**: The 100% gain exclusion under Section 1202 for gain on the sale or exchange of qualified small business stock held for more than five years by non-corporate taxpayers, which expired at the end of 2014, has been made permanent. The new law also permanently extends the rule that eliminates such gain as an AMT preference item.

- **Built in Gain Tax for S Corporations**: The five year reduced recognition period for S corporation built-in gains following conversion from a C corporation to an S corporation has been made permanent. Under the statute as originally enacted, that period was 10 years after the conversion to an S corporation. That period was shortened to 5 years for tax years beginning in 2012, 2013 and 2014. The time period was scheduled to revert to the original 10 years in 2015. PATH continues this 5-year provision for 2015 and permanently extends it for future years.

Key provisions of PATH providing *five year extensions for businesses* are as follows:

- **Bonus Depreciation**: The 50% bonus depreciation for property acquired and placed in service has been extended through 2017 and it reduces each year until eliminated by 2019. The phase-out schedule is 50% for 2015, 2016 and 2017; 40% for 2018; 30% for 2019; and will be eliminated after 2019.

- **New Markets Tax Credit**: This provision extends through 2019 the $3.5 billion of New Markets Tax Credit. The 50% immediate expensing of asset acquisition is permitted for 2015, 2016 and 2017, reduces to 40% for 2018, 30% for 2019, and will be eliminated after 2019.

Additional provisions of PATH include:

- **529 Plans**: The permissible distributions from a 529 Plan has been improved and expanded with three changes, effective after December 31, 2014. First, PATH expands the definition of qualified higher education expenses for which tax-preferred distributions from 529 accounts are eligible, 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 at an eligible education institution. Second, when determining the tax consequences of a distribution from a 529 plan, PATH repeals the rule requiring all 529 accounts to be aggregated. Now, if someone receives multiple distributions from a 529 plan, the tax consequences are computed on a distribution-by-distribution basis, rather than an aggregate basis. Third, PATH amends the statute to treat a refund of tuition paid with amounts distributed from a 529 account as a qualified expense if such amounts are re-contributed to a 529 account within 60 days.

- **ABLE Accounts**: The provision permits rollover of a 529 Plan account to an ABLE account penalty-free (subject to limitations) and eliminates the residency requirement of ABLE accounts. ABLE accounts (tax-preferred savings accounts for disabled individuals), which previously may be located only in the state of residence of the beneficiary (or a "contracting state"), may now be established in any state. Additionally, the provision allows for amounts from 529 accounts to be rolled over to an ABLE account without penalty. Such rolled-over amounts count towards the overall limitation on amounts that can be contributed to an ABLE account within a taxable year ($14,000 for 2016).

PATH addresses numerous other areas not outlined in this Alert, including measures affecting extensions of certain energy provisions, the Affordable Care Act, exempt organizations, modifications and clarifications to the tax rules for REITs, and IRS administration provisions.

For additional information, or to discuss how any of the provisions of PATH may impact you or your business, please contact the author of this Alert, **Laurence E. Fundler**, or any member of our **Tax, Trusts & Estates Department**.