The Norton Tax Bulletin

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Tax Extender Legislation

Dear Clients, family and friends,

Congress has reached a bipartisan agreement on tax extenders, aptly named "Protecting Americans from Tax Hikes Act of 2015". Much to everyone's surprise, some were made permanent while others were only extended for a period of time. Congress also modified several provisions and added new ones to reduce tax fraud. Here is a look at some of the key provisions included in the legislation that pertain to individuals, small businesses, and certain energy-related provisions:

INDIVIDUAL PROVISIONS:

- **Child Credit** – This credit was made permanent; it provides a $1,000 credit for each dependent child who is under the age of 17 at year's end, who lived with the taxpayer for over half of the year and who meets the relationship test. The credit phases out for higher-income taxpayers, and a portion of the credit is refundable for lower-income taxpayers. The changes also include program integrity provisions that prohibit an individual from retroactively claiming the child credit by amending a return (or filing an original return if he or she failed to file) for any prior year in which the individual for whom the credit is claimed did not have an ITIN – generally a Social Security number). After 2015, when a taxpayer improperly claims the credit, the legislation includes a disallowance period when no credit is allowed. For fraud, the disallowance period is 10 years, and for reckless or intentional disregard of rules and regulations, the disallowance period is 2 years.
- **American Opportunity Credit (AOTC)** – This credit, which was due to expire after 2017, *has been made permanent*. This is a tax credit equal to 40% of the cost of tuition and qualifying expenses for higher education, with a maximum credit of $2,500. The credit applies to 100% of the first $2,000 and 25% of the next $2,000 of qualifying expenses. The credit offsets any tax liability, and 40% of the credit is refundable even if the taxpayer does not have any tax liability. It also phases out between $160,000 and $180,000 for married taxpayers filing jointly and between $80,000 and $90,000 for others – except for married taxpayers filing separately, who get no credit.

  After 2015, when a taxpayer improperly claims the credit, the legislation includes a disallowance period when no credit is allowed. For fraud, the disallowance period is 10 years, and for reckless or intentional disregard of rules and regulations, the disallowance period is 2 years. A provision was added that prohibits an individual from retroactively claiming the AOTC by amending a return or filing a late original return for any prior year when the individual or a student for whom the credit is claimed did not have an ITIN (*generally a Social Security number*).

- **Earned Income Tax Credit (EITC)** – The EITC is a refundable credit allowed to certain low-income workers who have W-2 wages and self-employed income. The credit is larger for taxpayers with children. The credit for taxpayers with children is based upon the number of children; those with three or more children receive the highest credit – as much as $6,269 in 2015. The higher credit for three or more children, which was a temporary provision that was set to expire after 2017, has been made permanent._The changes also include added program integrity provisions that prohibit an individual from retroactively claiming the AOTC by amending a return (or filing an original return if the individual failed to file) for any prior year in which the individual for whom the credit is claimed did not have an ITIN (generally a Social Security number). The changes also reduced the marriage penalty by increasing the income phase-out for those filing jointly.
- **Teachers' $250 Above-the-Line Deduction** – This provision, which was available from 2002 through 2014, allows teachers and other eligible educators (*levels kindergarten through grade 12*) to take an above-the-line deduction of up to $250 for unreimbursed expenses incurred as part of their educational work. This deduction has been made permanent and modified by adjusting the $250 for inflation in years after 2015. In addition, professional development expenses were added to the qualified expenses allowed as part of the $250 deduction.
- **Transit Pass & Parking Fringe Benefit Parity** – From 2010 through 2014, the monthly exclusion amount for employer-paid transit passes and qualified parking were temporarily the same. The parity of these two fringe benefits has been made permanent. Thus, for 2015 they will both be $250.
- **Optional Deduction of State and Local General Sales Taxes** – Since 2004, taxpayers who itemized their deductions have had the option to deduct the Larger of (1) state and local income tax paid during the year, or (2) state and local sales tax paid during the year. This provision, which had been previously extended through 2014, provides the greatest benefit to those taxpayers who reside in a state that has no income tax (*which include Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming*). This election has been made permanent.
- **Above-the-Line Deduction for Qualified Tuition and Related Expenses** – This above-the-line deduction for qualified higher education tuition and related expenses had been available from 2002 through 2014. The deduction includes adjusted gross income (AGI) limitations; ***it is not allowed for joint filers with an AGI of $160,000 or more ($85,000 for other filing statuses***). This deduction has been retroactively extended through 2016.
- **Tax-Free IRA Distributions For Charitable Purposes** – This provision was temporarily added in 2004 and originally expired in 2011; it was not extended until late in the year during the years 2012, 2013 and 2014, thus limiting its application in those three years. The provision allows taxpayers age 70 1/2 and over to directly transfer (not roll over) funds from their IRA accounts to a qualified charity. The distribution is not taxable, but it does count toward the individuals' required minimum distribution (RMD) for the year. The maximum allowable transfer is $100,000 per year. *No charitable deduction is allowed, as the distribution is not taxable*. This provision has been made permanent; it provides four potential tax advantages:

  1. The distribution is not included in income, thus lowering the taxpayer's AGI, which in turn helps to avoid various AGI phase-outs and limitations.
  2. Keeping the AGI lower also helps to minimize the amount of Social Security income

that is subject to tax for some taxpayers.
3. Taxpayers using the standard deduction cannot get a charitable deduction, but they are essentially deducting the charitable deduction from their gross income when making contributions this way.
4. The transferred distribution counts towards the taxpayer's RMD for the year.

- **Discharge of Qualified Principal Residence Indebtedness** – When an individual loses his or her home to foreclosure, abandonment or short sale or has a portion of his or her loan forgiven under the HAMP mortgage reduction plan, that person generally will end up with **cancellation of debt** (COD) income. COD income is taxable unless the taxpayer can exclude it. A taxpayer can exclude the COD income in the extent that he or she is insolvent (*with debts exceeding assets immediately before the event occurs*) using the insolvency exclusion.

  Due to the housing market crash, in 2007, Congress added the qualified principal residence COD exclusion, which allowed taxpayers to exclude COD income to the extent that it was discharged acquisition debt. Acquisition debt is debt originally incurred to acquire a home or substantially improve it – *not debt used for other purposes, which is called equity debt.* However, equity debt is deemed to be discharged first, thus limiting the exclusion when both equity and acquisition debt are involved in the transaction. The qualified principal residence COD exclusion had been previously extended but had expired at the end of 2014. This exclusion has been retroactively extended through 2016 (a two-year extension).
- **Mortgage Insurance Premiums** – For tax years 2007 through 2014, taxpayers could deduct (*as an itemized deduction*) the cost of premiums for qualified mortgage insurance on a qualified personal residence (first or second home). To be deductible, the premiums must have been related to acquisition debt incurred after Dec. 31, 2006. However, this deduction phases out for higher-income taxpayers (*generally those whose AGI exceeds $100,000*). This provision, which had expired after 2014, has been retroactively extended through 2016, a two-year extension.
- **Affordable Care Act (Obamacare)** – *this was not a provision of the act, but is important for taxpayers to remember when filing their returns for 2015.* Eligible individuals who get health insurance through the health insurance marketplace can have Advance Payments of the **Premium Tax Credit** (APTC) made directly to their insurance provider to reduce their monthly premiums. Taxpayers receiving APTCs must file a tax return to reconcile the APTC on IRS 8962, regardless of whether they otherwise had a tax filing requirement [IRC Sec. 36B(f)]. In a letter to Congress IRS Commissioner, John Koskinen, said that preliminary data from the 2015 filing season indicates that about one-third of the 4.6 million taxpayers who received APTCs for 2014 coverage didn't report the credit on their 2014 tax returns (ouch!!). The IRS is evaluating the discrepancy and looking for methods to ensure that practitioners and taxpayers are accurately reporting the credit and filing IRS 8962 correctly. It also contacts taxpayers who received an APTC and didn't complete the filing requirements correctly.

BUSINESS PROVISIONS:

- **Research Credit** – Tax law provides a tax credit of up to 20% of qualified expenditures for businesses that develop, design or improve products, processes, techniques, formulas or software (and similar activities). The credit has been available off and on since 1981 without being made permanent. It had been extended several times but had expired at the end of 2014. This credit has been retroactively made permanent. In addition, it is not a tax preference for small businesses.

- **100% Exclusion of Gain** – Certain Small Business Stock – Previously, for stock issued after September 27, 2010, and before January 1, 2015, non-corporate taxpayers could exclude 100% of any gain realized on the sale or exchange of "qualified small business stock" held for more than 5 years. In addition, there was no alternative minimum tax (AMT) preference when the exclusion percentage was 100%. Generally, the term "qualified small business" means any domestic C corporation with assets of $50 million or less. This provision has been made permanent.
- **Differential Wage Payment Credit** – Through 2014, eligible small business employers – generally those that have an average of fewer than 50 employees and that pay a individual called into active duty military service all or part of the wages that they would have otherwise received from the employer – can claim a credit. This differential wage payment credit is equal to 20% of up to $20,000 of differential pay made to an employee during the tax year. This credit has been retroactively made permanent; for years after 2015, the credit will apply to any size employer.
- **Work Opportunity Tax Credit (WOTC)** – Through 2014, employers could elect to claim a WOTC for up to 40% of employees' first-year wages for hiring workers from targeted groups – not exceeding wages of $6,000 (a maximum credit of $2,400). First-year wages are wages paid during the tax year for work performed during the one-year period beginning on the date when the employee begins work for the employer. This credit has been retroactively extended for five years through 2019; it applies to veterans and non-veterans and adds qualified long-term unemployment recipients to the list of targeted groups for years after 2015.
- **Section 179 Election** – Since 2003, the Section 179 election has been temporarily increased from its statutory limit of $25,000 to between $100,000 and $500,000. Since 2010, the expense cap has been $500,000 (or $250,000 on a married-filing-separate tax return), and the investment limit has been $2 million. However, the last extension expired after 2014; without an extension, the cap would have returned to the statutory $25,000 limit in 2015. The statutory expensing limit of $500,000 and the $2 million investment limit have both been made permanent. The application of the Section 179 election to "off-the-shelf" computer software, qualified leasehold improvements, qualified restaurant property and qualified retail improvements has also been made permanent.
- **Leasehold and Retail Improvements and Restaurant Property** – The class life for qualified leasehold and retail Improvements and restaurant property had been temporarily included in the 15-year depreciation class life, as opposed to the 31-year category. Qualified leasehold and retail Improvements and restaurant property have been retroactively and permanently included in the 15-year MACRS class life.

- **Bonus Depreciation** – As a means of stimulating the economy, a 50 percent bonus depreciation was temporarily implemented in 2008 and subsequently extended through 2014. For the period between September 8, 2010, and before January 1, 2012, it was even boosted to 100 percent. Bonus depreciation applies to personal tangible property placed in service during the year for which the original use began with the taxpayer.

  The 50% bonus depreciation has been extended for 2 years (*through 2016*) for property placed in service before January 1, 2017. This generally applies to property with a class life of 20 years or less, to qualified leasehold improvements and to certain plants bearing fruits and nuts that are planted or grafted before January 1, 2020.

- **Enhanced First** - Year Depreciation for Autos and Trucks – This is the so-called "luxury limit" on the deprecation deduction of passenger automobiles and light trucks used for business. For such vehicles placed in service in 2015, the limits are $3,160 and $3,460, respectively. In the past, the bonus depreciation had increased the first-year luxury limits by $8,000. Under the new law, the bonus depreciation applicable to luxury vehicles will be phased out through 2019. Thus, the luxury auto rates will be increased by the following bonus depreciation rates: $8,000 for 2015 through 2017, $6,000 for 2018 and $4,800 for 2019.

ENERGY PROVISIONS:

- **Residential Energy (Efficient) Property Credit** – From 2006 through 2014, a nonrefundable credit had been available for qualified improvements to make the taxpayer's existing primary home more energy efficient. Qualified improvements generally included insulation, storm windows and doors certain types of energy-efficient roofing materials, and energy-efficient air conditioning and hot-water systems. The credit was equal to 10% of the improvement's cost (not including installation), with a lifetime credit of $500. The credit has been retroactively extended through 2016 (two years).
- **Credit for Fuel-Cell Vehicles** – Through 2014, a taxpayer could claim a credit for vehicles fueled by chemically combining oxygen with hydrogen to create electricity. Generally, the credit was $4,000 for vehicles weighing 8,500 pounds or less (and up to $40,000 for heavier vehicles, depending on their weight). An additional $1,000 to $4,000 credit was available for cars and light trucks to the extent that their fuel economy exceeded the 2002 base fuel economy set forth in the Internal Revenue Code. This credit has been retroactively extended for two years through 2016.

IDENTITY PROTECTION PIN

New for the 2015 tax season, taxpayers who were the victim (*or the IRS believes were a victim*) of identity theft ***must*** include their IP PIN on their tax return whether submitted electronically or on paper. An IP PIN helps the IRS verify a taxpayer's identity and accept their electronic or paper tax return. When you have an IP PIN, it prevents someone else from filing a tax return with your SSN.

If a return is e-filed with your SSN and an incorrect or missing IP PIN, the IRS system will reject it until you submit it with the correct IP PIN or you file on paper. If the same conditions occur on a paper-filed return, the IRS will delay its processing and any refund you may be due

for your protection while they determine if it's yours. More information on the IP PIN is on the IRS website (www.irs.gov). Most taxpayers affected should have received a letter in December with their IP PIN. Be sure to give a copy of the letter to your tax preparer!!!!!

FOR MY TAX PREPARATION CLIENTS

The 2015 tax organizer is done and should be e-mailed to you this week. If you do NOT receive it by this Sunday (January 17th), let me know and I will ensure you get one. It will also be available on my website under the FOR CLIENTS ONLY section next week. If you need the passcode to get into that section, just e-mail me.

SUMMARY

I hope that you find the information in this newsletter of value to you as you begin 2016 and approach the upcoming filing season.

Happy New Year!

Very truly yours,

Dick Norton

> ***This newsletter is not intended or written by me to constitute written advice that you may rely upon to avoid penalties that may be imposed by any taxing authority. Selection of a tax entity may have considerations beyond simply its tax treatment. Therefore, I advise clients to always first consult with an attorney who is intimately familiar with business forms and their relevance to potential future tax and financial issues.***