INDIVIDUAL TAX BREAKS IN THE "PROTECTING AMERICANS FROM TAX HIKES" ACT

On December 18, Congress passed and the President signed into law a bipartisan, bicameral agreement on tax extenders - i.e., the 50 or so temporary tax provisions that are routinely extended by Congress on a one- or two-year basis - and numerous other tax provisions in the "Protecting Americans from Tax Hikes (PATH) Act of 2015" (the Act). The agreement makes permanent many of the individual and business extenders and contains provisions on Real Estate Investment Trusts (REITs), IRS administration, the Tax Court and miscellaneous other rules.

As explained in this *Hot Topic*, the PATH Act makes permanent the enhanced child tax credit, the enhanced American opportunity tax credit, the enhanced earned income tax credit, the deduction for certain expenses of elementary and secondary school teachers, parity for exclusion from income for employer-provided mass transit and parking benefits, the deduction of State and local general sales taxes and the tax-free distributions from individual retirement plans for charitable purposes. In addition, the Act provides for a retroactive extension of a host of other individual tax provisions had expired at the end of 2014.

Enhanced Child Tax Credit Made Permanent

The Child Tax Credit (CTC) allows taxpayers to claim a $1,000 tax credit for each qualifying child under age 17 which the taxpayer can claim as a dependent. The CTC phases out when taxpayers' income exceeds certain thresholds. To the extent the CTC exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit equal to 15% percent of earned income in excess of a threshold dollar amount.

Under pre-Act law, through 2017, the threshold dollar amount was an unindexed $3,000, and was then scheduled to rise to $10,000, indexed for inflation.

> **New law.** The Act makes the enhanced CTC permanent by setting the threshold dollar amount for purposes of computing the refundable credit at an unindexed $3,000. This change is effective for tax years beginning after December 18, 2015 (i.e., the enactment date).
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> **Program integrity provisions**. Also included in the Act are "program integrity" checks for the CTC, as well as other credits (described below) designed to reduce improper payments. Effective for returns, and any amendment or supplement to a return, filed after December 18, 2015, the Act prohibits an individual from retroactively claiming the CTC by amending a return (or filing an original return if he failed to file) for any prior year in which the individual or a qualifying child for whom the credit is claimed did not have an individual tax identification number (ITIN).
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> In addition, for tax years beginning after December 31, 2015, the paid-preparer due diligence penalty, which currently applies with respect to the earned income tax credit

(EITC), will also apply to those who fail to exercise due diligence in determining eligibility for the CTC. And similarly, for tax years beginning after December 31, 2015, the current law requirement which prohibits individuals from claiming the EITC for: (I) 10 years if they are convicted of fraud; or (ii) two years, if they intentionally disregarded the rules, also will apply to the CTC, as well the rule which allows the IRS to disallow credits without a formal audit if they are claimed in a period during which the taxpayer is barred from doing so due to fraud or reckless or intentional disregard.

Enhanced American Opportunity Tax Credit Made Permanent

The Hope Scholarship Credit is a credit of $1,800 (indexed for inflation) for various tuition and related expenses for the first two years of post-secondary education. It phases out for AGI starting at $48,000 (if single) and $96,000 (if married filing jointly), with indexing for inflation.

Under pre-Act law, through 2017, the American Opportunity Tax Credit (AOTC; essentially a modified version of the pre-existing Hope credit) increased the above credit to $2,500 for four years of post-secondary education, and increased the beginning of the phase-out amounts to $80,000 (single) and $160,000 (married filing jointly).

New law. The Act makes the AOTC permanent.

Program integrity provisions. Effective for returns, and any amendment or supplement to a return, filed after December 18, 2015, the Act prohibits an individual from retroactively claiming the AOTC by amending a return (or filing an original return if he failed to file) for any prior year in which the individual or a student for whom the credit is claimed did not have an ITIN. However, the preceding change doesn't apply for timely filed returns for tax year 2015.

In addition, for tax years beginning after December 31, 2015, the paid-preparer due diligence penalty which currently applies with respect to the earned income tax credit (EITC), will also apply to those who fail to exercise due diligence in determining eligibility for the AOTC. And similarly, for tax years beginning after December 31, 2015, the current law which prohibits individuals from claiming the EITC for: (I) 10 years if they are convicted of fraud; or (ii) two years, if they intentionally disregarded the rules, also apply to the AOTC, as well as the rule which allows the IRS to disallow credits without a formal audit if they are claimed in a period during which the taxpayer is barred from doing so due to fraud or reckless or intentional disregard.

For tax years beginning after December 31, 2015, and expenses paid after that date for education furnished in academic periods beginning after that date, a taxpayer claiming the AOTC must report the employer identification number of the educational institution to which the taxpayer makes qualified payments under the credit.

Finally, for expenses paid after December 31, 2015, for education furnished in academic periods beginning after that date, higher education institutions are required to report (on Form 1098-T) only qualified tuition and related expenses actually paid (rather than choosing between amounts paid and amounts billed, as under current law).

Enhanced Earned Income Tax Credit Made Permanent

Certain low- and moderate-income workers may be eligible for a refundable EITC. The amount of the credit depends on the taxpayer's earned income and the number of qualifying children, if any, and is calculated as a percentage of an inflation-adjusted earned income level.

Under pre-Act law, through 2017, the EITC amount was temporarily increased (to 45%) for those with three or more children, and the EITC marriage penalty was reduced by increasing the income phase-out range by $5,000 (indexed for inflation) for those who are married and filing jointly.

> **New law.** The Act makes these provisions permanent.
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> **Program integrity provisions.** Effective for returns, and any amendment or supplement to a return, filed after December 18, 2015, the Act prohibits an individual from retroactively claiming the EITC by amending a return (or filing an original return if he failed to file) for any prior year in which the individual or a student for whom the credit is claimed did not have a valid social security number. However, the preceding change doesn't apply for timely filed returns for tax year 2015.

Above-the-Line Deduction for Educator Expenses Made Permanent

Under pre-Act law, eligible elementary and secondary school teachers could, for tax years beginning before January 1, 2015, claim an above-the-line deduction for up to $250 per year of expenses paid or incurred for books, certain supplies, computer and other equipment, and supplementary materials used in the classroom.

Under pre-Act law, this above-the-line deduction was unavailable for tax years beginning after December 31, 2014.

> **New law.** The Act permanently extends the educator expense deduction and, for tax years beginning after December 31, 2015, modifies the deduction by (I) indexing the $250 amount for inflation, and (ii) treating professional development expenses as expenses eligible for the deduction.
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> **Observation**: Without this deduction, unreimbursed professional development expenses would be deductible only as unreimbursed employee business expenses - miscellaneous itemized deductions subject to the 2%-of-adjusted gross income (AGI) floor.

Increase in Excluded Employer-Provided Mass Transit and Parking Benefits Made Permanent

For 2015, an employee could exclude from gross income up to: (1) $250 per month for qualified parking, and (2) $130 a month for transit passes and commuter transportation in a commuter highway vehicle (including van pools). However, notwithstanding the applicable statutory limits on the exclusion of qualified transportation fringes (as adjusted for inflation), for any month beginning before January 1, 2015, a parity provision required the monthly dollar limitation for transit passes and transportation in a commuter highway vehicle had to be applied as if it were the same as the dollar limitation for that month for employer-provided parking ($250 for 2014).

New law. For months after December 31, 2014, the Act permanently extends the maximum monthly exclusion amount for transit passes and van pool benefits so that these transportation benefits match the exclusion for qualified parking benefits. These fringe benefits are excluded from an employee's wages for payroll tax purposes and from gross income for income tax purposes.

Observation: As it has in past years when parity between mass transit and parking benefits was retroactively revived, the IRS doubtless will issue a notice providing guidance on how employers should handle the retroactive 2015 increase in the monthly exclusion for employer-provided transit and vanpooling benefits.

State and Local Sales Tax Deduction Made Permanent

Taxpayers who itemize deductions could, for tax years beginning before January 1, 2015, elect to deduct state and local general sales and use taxes instead of state and local income tax.

Under pre-Act law, this choice was unavailable for tax years beginning after December 31, 2014.

New law. Effective for tax years beginning after 2014, the Act retroactively revives and makes permanent the option to claim an itemized deduction for State and local general sales taxes in lieu of an itemized deduction for State and local income taxes. The taxpayer may either deduct the actual amount of sales tax paid in the tax year, or alternatively, deduct an amount prescribed by the IRS.

Liberalized Rules for Qualified Conservation Contributions Made Permanent

A taxpayer's aggregate qualified conservation contributions (i.e., contributions of appreciated real property for conservation purposes) were, for tax years beginning before January 1, 2015, allowed up to the excess of 50% of the taxpayer's contribution base over the amount of all other allowable charitable contributions (100% for qualified farmers and ranchers), with a 15-year carryover of such contributions in excess of the applicable limitation.

Under pre-Act law, these rules didn't apply to any contribution made in a tax year beginning after December 31, 2014, and contributions made thereafter were to be subject to the otherwise applicable 30% limit for capital gain property (50% limit for qualified farmers and ranchers).

New law. Effective for contributions made in tax years beginning after December 31, 2014, the Act retroactively revives and permanently extends the charitable deduction for contributions of real property for conservation purposes and the enhanced deduction for certain individual and corporate farmers and ranchers. The Act also modifies the deduction beginning in tax years after December 31, 2015, to permit Alaska Native Corporations to deduct donations of conservation easements up to 100% of taxable income.

Nontaxable IRA Transfers to Eligible Charities Made Permanent

Taxpayers who are age 70½ or older could, in tax years beginning before January 1, 2015, make tax-free distributions to a charity from an Individual Retirement Account (IRA) of up to $100,000 per year. These distributions weren't subject to the charitable contribution percentage limits since they were neither included in gross income nor claimed as a deduction on the taxpayer's return.

Under pre-Act law, these rules didn't apply to distributions made in tax years beginning after December 31, 2014.

New law. Effective for distributions made in tax years beginning after December 31, 2014, the Act retroactively revives and permanently extends the ability of individuals at least 70½ years of age to exclude from gross income qualified charitable distributions from IRAs of up to $100,000 per year.

Exclusion for Discharged Home Mortgage Debt Retroactively Extended Through 2016

Discharge of indebtedness income from qualified principal residence debt, up to a $2 million limit ($1 million for married individuals filing separately), was, in tax years beginning before January 1, 2015, excluded from gross income.

Under pre-Act law, this exclusion didn't apply to any debt discharged after December 31, 2014.

New law. The Act extends this exclusion for two years so that it applies to home mortgage debt discharged before January 1, 2017. For discharges of debt after December 31, 2015, the exclusion also applies to home mortgage debt that's discharged subject to a written arrangement that's entered into before January 1, 2017. Thus, according to an official summary of the bill, the exclusion applies to qualified principal residence debt that is discharged in 2017, if the discharge is pursuant to a binding written agreement entered into in 2016.

Mortgage Insurance Premiums as Deductible Qualified Residence Interest Retroactively Extended Through 2016

Mortgage insurance premiums paid or accrued before January 1, 2015 by a taxpayer in connection with acquisition indebtedness with respect to the taxpayer's qualified residence were treated as deductible qualified residence interest, subject to a phase-out based on the taxpayer's AGI. The amount allowable as a deduction was phased out ratably by 10% for each $1,000 by which the taxpayer's adjusted gross income exceeded $100,000 ($500 and $50,000, respectively, in the case of a married individual filing a separate return). Thus, the deduction wasn't allowed if the taxpayer's AGI exceeded $110,000 ($55,000 in the case of married individual filing a separate return).

Under pre-Act law, this provision only applied to premiums paid or accrued before January 1, 2015 (and not properly allocable to any period after that date).

> **New law.** Effective for amounts paid or accrued after December 31, 2014, the Act retroactively extends this provision for two years so that a taxpayer can deduct, as qualified residence interest, mortgage insurance premiums paid or accrued before January 1, 2017 (and not properly allocable to any period after 2016).

Above-the-Line Deduction for Higher Education Expenses Retroactively Extended Through 2016

Eligible individuals could, for tax years beginning before January 1, 2015, deduct higher education expenses - i.e., “qualified tuition and related expenses” of the taxpayer, his spouse, or dependents - as an adjustment to gross income to arrive at AGI. The maximum deduction was $4,000 for an individual whose AGI for the tax year doesn't exceed $65,000 ($130,000 in the case of a joint return), or $2,000 for individuals who don't meet the above AGI limit, but whose AGI doesn't exceed $80,000 ($160,000 in the case of a joint return). No deduction was allowed for an individual whose adjusted gross income exceeds the relevant adjusted gross income limitations, for a married individual who does not file a joint return, or for an individual for whom a personal exemption deduction may be claimed by another taxpayer for the tax year.

Under pre-Act law, this deduction wasn't available for tax years beginning after December 31, 2014.

> **New law.** Effective for tax years beginning after December 31, 2014, the Act retroactively extends through 2016 the above-the-line deduction for qualified tuition and related expenses for higher education.

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