NON EXTENDER PROVISIONS 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 which 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, which 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 Act provides for a number of miscellaneous provisions, the most significant of which are discussed here.

Gross income doesn't include any amount received as a qualified scholarship by an individual who's a candidate for a degree at an educational organization. However, the exclusion generally doesn't apply to that part of the amount received which represents payment for teaching, research or other services (sometimes referred to as the "payment-for-services rule").

Under pre-Act law, statutory exceptions to the payment-for-services rule apply for amounts received by an individual under either the National Health Service Corps Scholarship program or the Armed Forces Health Professions Scholarship and Financial Assistance program. No statutory exception applies for amounts received under a work college program.

> **New law**. For amounts received in tax years beginning after date of enactment, the Act exempts from gross income any payments from certain work-learning-service programs that are operated by a work college.

Delayed Refunds Where Taxpayer Claims Earned Income or Additional Child Credit

The earned income tax credit (EITC) is a refundable credit available to low-income workers who satisfy certain requirements.

Subject to income limitations, an individual may claim a tax credit, the child tax credit, for each qualifying child under the age of 17. To the extent the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit).

> **New Law**. Effective for credits or refunds made after December 31, 2016, no credit or refund for an overpayment for a tax year will be made to a taxpayer before the 15th day of the second month following the close of that tax year (generally February 15 of the following year), if the taxpayer claimed the EITC or additional child tax credit on the tax return.

Changes to 529 Plan Distribution Rules

Nondeductible cash contributions can be made to a qualified tuition program (QTP or 529 plan) on behalf of a designated beneficiary. The earnings on the contributions build up tax-free, and distributions from the QTP are excludible to the extent used to pay qualified higher education expenses.

For expenses paid or incurred in 2009 or 2010, qualified higher education expenses included certain expenses for the purchase of any computer technology or equipment or Internet access and related services.

Any distribution from a QTP that isn't used for qualified higher education expenses is inculpable in the distributee's gross income using the annuity rules, which result in a portion of the distribution being included in gross income and a portion being excluded as a return of the amount contributed. There is a requirement to aggregate all of a beneficiary's QTPs when determining the taxable part.

> **New law**. For tax years that begin after December 31, 2014, the Act expands the definition of qualified higher education expenses for which tax-preferred distributions from 529 accounts are eligible to include the 2009/2010 computer equipment and technology rule.
>
> For distributions made after December 31, 2014, the Act modifies the 529-account rules to treat any distribution from a 529 account as coming only from that account, even if the individual making the distribution operates more than one account.
>
> And, the Act treats 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. This provision is effective for refunds after 2014, or in the case of refunds after 2014 and before the date of enactment, for refunds re-contributed not later than 60 days after date of enactment.

Residency Requirement Eliminated for ABLE Programs

Under Code Sec. 529A (which was added by the Achieving a Better Life Experience Act of 2014 (ABLE Act), a part of the Tax Increase Prevention Act of 2014), for tax years beginning after December 31, 2014, states may establish qualified ABLE programs under which contributions may be made to an ABLE account that is established for the purpose of meeting the qualified disability expenses of the designated beneficiary of the account who is a resident of that state and who is disabled.

Under pre-Act law, such tax-preferred savings accounts could only be located only in the State of residence of the beneficiary.

> **New law**. For tax years beginning after December 31, 2014, the Act allows ABLE accounts to be established in any State. This will allow individuals setting up ABLE accounts to choose the State program which best fits their needs, such as with regard to investment options, fees and account limits. The provision applies to tax years beginning before, on or after the date of enactment.

Prevention of Extension of Tax Collection Period For Certain Armed Forces Members

The Code provides that the statute of limitations within which a tax may be collected after assessment is generally 10 years after assessment.

In general, IRS's rights with respect to the determination, assessment and collection of the tax liability of individuals serving in the Armed Forces are suspended for: (1) the period during which the individual served in a designated combat zone or a contingency operation, plus (2) the period of continuous qualified hospitalization as a result of an injury suffered while serving in a combat zone, plus (3) a 180-day period after the termination of such hospitalization.

> **New law**. With respect to taxes assessed before, on or after the date of the enactment, the Act provision requires that the collection period for members of the Armed Forces hospitalized for combat zone injuries may not be extended by reason of any period of continuous hospitalization or the 180 days after hospitalization. Accordingly, the collection period expires 10 years after assessment, plus the actual time spent in a combat zone. The provision applies to taxes assessed before, on or after the date of the enactment.

New Exclusion for Wrongfully Incarcerated Individuals

The Code excludes from gross income any damages received on account of personal physical injuries or physical sickness, whether by suit or agreement and whether as a lump sum or as periodic payments. This exclusion doesn't apply to punitive damages.

Under current law, there are no provisions that provide an exclusion for damages related to wrongful incarceration.

> **New law**. The Act allows an individual to exclude from gross income civil damages, restitution or other monetary awards which the taxpayer received as compensation for a wrongful incarceration. A "wrongfully incarcerated individual" is either: (1) an individual who was convicted of a criminal offense under Federal or state law, who served all or part of a sentence of imprisonment relating to such offense, and who was pardoned, granted clemency or granted amnesty because of actual innocence of the offense; or (2) an individual for whom the conviction for such offense was reversed or vacated and for whom the indictment, information or other accusatory instrument for such offense was dismissed or who was found not guilty at a new trial after the conviction was reversed or vacated.

Rollover Allowed From Retirement Plans to SIMPLE Accounts

The Code provides that the only contributions allowed to a SIMPLE IRA (also called a SIMPLE retirement account) are contributions under a qualified salary reduction arrangement or rollovers or transfers from another SIMPLE IRA.

Early withdrawals from a SIMPLE retirement account are subject to the 10% early withdrawal tax which apples to early IRA withdrawals. However, the early withdrawal tax rises to 25% for withdrawals of contributions made during the two-year period beginning on the date the employee first participates in any qualified salary reduction arrangement maintained by the employee's employer.

New law. For contributions after the date of enactment, the Act allows a taxpayer to roll over amounts from an employer-sponsored retirement plan (e.g., 401(k) plan) to a SIMPLE IRA, if the plan has existed for at least two years. Specifically, a rollover may be made from a traditional IRA, a qualified trust, a qualified annuity, a 403(b) tax-sheltered annuity or a governmental plan. But no rollover contribution is allowed to be made to the SIMPLE retirement account until after the two-year period (the two-year period beginning on the date the employee first participated in a qualified salary reduction arrangement maintained by the employee's employer).

Requirements for the Issuance of Individual Taxpayer Identification Numbers

Any individual filing a U.S. tax return is required to state his or her taxpayer identification number on that return. Generally, a taxpayer identification number is the individual's Social Security number ("SSN"). However, in the case of individuals who are not eligible to be issued an SSN, but who still have a tax filing obligation, the IRS issues individual taxpayer identification numbers ("ITINs") for use in connection with the individual's tax filing requirements.

The IRS has set out rules for applying for an ITIN, including rules regarding the completion of Form W-7, "Application For IRS Individual Taxpayer Identification Number," submission of specific types of documentation (e.g., passports and birth certificates), and how and to whom a Form W-7 may be submitted.

ITINs are deactivated if the ITIN was not used during any tax year for a period of five consecutive years.

New law. The Act provides that the IRS may issue ITINs if the applicant provides the documentation required by IRS either (a) in person to an IRS employee or to a community-based certified acceptance agent (as authorized by IRS), or (b) by mail. Individuals who were issued ITINs before 2013 are required to renew their ITINs on a staggered schedule between 2017 and 2020. An ITIN will expire if an individual fails to file a tax return for three consecutive years. These provisions are effective for requests for ITINs made after the date of enactment.

The Act also directs the IRS to study the current procedures for issuing ITINs with a goal of adopting a system by 2020 which would require all applications to be filed in person.

Accelerated Due Dates for W-2, 1099, Etc. forms

For wages paid to employees, and taxes withheld from employee wages, payors must file a Form W-2 return with the Social Security Administration by February 28 of the year following the calendar year for which the return must be filed, using Form W-3, Transmittal of Wage and Tax Statements. The due date for these information returns filed electronically is March 31.

And, present law requires persons to file an information return with IRS, concerning certain transactions involving the payment of non-employee compensation. Generally, these returns are on Forms in the 1099 series. Payors generally must file the information return with IRS on or before the last day of February of the year following the calendar year for which the return must be filed. However, the due date for most information returns filed electronically is March

31.

New law. The Act requires forms W-2, W-3, and returns to report non-employee compensation (e.g., Form 1099-MISC), to be filed on or before January 31 of the year following the calendar year to which such returns relate. Those returns are no longer eligible for the extended filing date for electronically filed returns. This provision is effective for returns and statements relating to calendar years after the date of enactment (e.g., filed in 2017).

Safe Harbor for De Minimis Errors on Information Returns and Payee Statements

Except where there is reasonable cause and no willful neglect and subject to certain other exceptions, any failure to include all of the information required to be shown on an information return or a payee statement with respect to an information return, or any inclusion of incorrect information on an information return or payee statement, is subject to a penalty. The amount of the penalty depends on various factors, including whether the payor is a small business.

New law. The Act establishes a safe harbor from penalties for the failure to file correct information returns and for failure to furnish correct payee statements, by providing that, generally, if the error is $100 or less ($25 or less in the case of errors involving tax withholding), the issuer of the information return is not required to file a corrected return and no penalty is imposed.

Under the exception to this rule, if any person receiving payee statements requests a corrected statement, the penalty for failure to file a correct information return and the penalty for failure to furnish a correct payee statement would continue to apply in the case of de minimis errors on that statement.

These provisions are effective for returns and statements required to be filed after December 31, 2016.

Moratorium on Medical Device Excise Tax

A tax equal to 2.3% of the sale price is imposed on the sale of any taxable medical device by the manufacturer, producer or importer of such device. A taxable medical device is any device defined in the applicable section of the Federal Food, Drug, and Cosmetic Act (FFDCA) that's intended for humans. The FFDCA defines "device" as an instrument, apparatus, implement, machine, contrivance, implant, in vitro reagent or other similar or related article. There's a retail exemption for items such as eyeglasses, contact lenses and hearing aids.

New law. The Act provides for a two-year moratorium on the 2.3% excise tax imposed on the sale of medical devices so that the tax will not apply to sales during calendar years 2016 and 2017.

Agricultural Research Organizations Are 50% Charities

Contributions by an individual to an organization that is a "50% charity" are deductible up to 50% of the donor's contribution base, which is the donor's adjusted gross income (AGI), computed without any net operating loss (NOL) carryback deduction. A 30% limitation applies to an individual's contributions to a 50% charity of appreciated capital gain property, i.e., a capital asset the sale of which at its fair market value at the time of the contribution would have resulted in long-term capital gain.

Under pre-Act law, a medical research organization that isn't a hospital qualifies as a 50% charity, but an agricultural research organization does not.

> **New law**. For contributions on or after the date of enactment, the Act adds agricultural research organizations to the list of 50% charities. The organization must commit to use the contribution for agricultural research before January 1 of the fifth calendar year which begins after the date of the contribution.
>
> In addition, in determining whether its activities consists of attempting to influence legislation by propaganda or otherwise (and so jeopardizing its tax-exempt status), the Act allows agricultural research organizations to make the lobbying expenditures test election and have its lobbying expenditures measured by the lobbying ceiling and grass roots ceiling amounts (i.e., based a sliding-scale percentage of the organization's exempt purpose expenditures).

Clarification of Valuation Rule for Charitable Remainder Unitrust's Early Termination

When a grantor funds a charitable remainder annuity trust (CRAT) or a charitable remainder unitrust (CRUT), he generally may take an income tax charitable deduction equal to the present value of the charitable remainder interest of the trust determined on the date of the transfer (or, in the case of a testamentary transfer, on the date of the decedent's death or an alternate valuation date). In determining the grantor's charitable contribution, the remainder interest of a CRAT or CRUT (including a net income only CRUT (NICRUT) and net income CRUT with a make-up feature (NIMCRUT)) is computed on the basis that an amount equal to 5% of the net fair market value of its assets (or a greater amount, if required under the terms of the trust instrument) is to be distributed each year to the income beneficiary. In the case of a NICRUT or a NIMCRUT, the net income limitation is disregarded.

Under pre-Act law, the Code does not provide a rule for valuing the interests in a charitable remainder trust in the event of an early termination of the trust.

> **New law**. Effective for the termination of trusts after the date of enactment, the Act clarifies the valuation method for the early termination of certain charitable remainder unitrusts. In the case of the early termination of a NICRUT or NIMCRUT, the remainder interest is valued using rules similar to the rules for valuing the remainder interest of a charitable remainder trust when determining the amount of the grantor's charitable contribution deduction. In other words, the remainder interest is computed on the basis that an amount equal to 5% of the net fair market value of the trust assets (or a greater amount, if required under the terms of the trust instrument) is to be distributed each year, with any net income limit being disregarded.

Alternative Tax for Small Insurance Companies Modified

Insurance companies other than life insurance companies (i.e., nonlife insurance companies) with net written premiums, or direct written premiums if greater, not in excess of $1.2 million in the tax year, have the right to elect to be taxed, at regular corporate rates, only on taxable investment income, instead of being taxed on both investment and underwriting income. Net written premiums generally means gross premiums, including deposits and assessments, written or received on insurance contracts during the tax year, less return premiums and premiums for reinsurance. Generally, direct written premiums are the gross amount of premiums received by a nonlife insurance company for directly issued (not reinsurance) insurance policies.

> **New law**. Effective for tax years beginning after December 31, 2016, the Act increases the maximum amount of annual premiums that small property and casualty insurance companies can receive and still elect to be exempt from tax on their underwriting income (and instead be taxed only on taxable investment income), from $1.2 million to $2.2 million (adjusted for inflation). The Act requires that no more than 20% of net written premiums (or if greater, direct written premiums) for a tax year be attributable to any one policyholder. Alternatively, a company is eligible for this exception if each owner of the insured business or assets has no greater an interest in the insurer than he has in the business or assets, and each owner holds no smaller an interest in the business than his interest in the insurer.

Alternative Tax Rate for Corporation's Timber Gains

Under the Code, if a taxpayer cuts standing timber, the taxpayer may elect to treat the cutting as a sale or exchange eligible for capital gains treatment. The timber's fair market value (FMV) on the first day of the tax year in which the timber is cut is used to determine the gain attributable to the cutting. The FMV is considered the taxpayer's cost of the cut timber for all purposes, including in determining the taxpayer's income from later sales of the timber or timber products. Under the Code, if a taxpayer disposes of the timber with a retained economic interest or makes an outright sale of the timber, the gain is eligible for capital gain treatment. Treatment under either of these provisions requires the taxpayer has owned the timber or held the contract right for a period of more than one year.

The maximum regular rate of tax on the net capital gain of an individual is 20%, but certain gains are subject to an additional 3.8% tax. The net capital gain of a corporation is taxed at the same rates as ordinary income, up to a maximum rate of 35%.

> **New law**. Effective for tax years beginning in 2016, the Act provides that a C corporation is subject to a 23.8% alternative tax rate for corporations on the portion of its taxable income which consists of qualified timber gain (or, if less, the net capital gain) for a taxable year. Qualified timber gain means the net gain for the tax year, determined by taking into account only trees held more than 15 years.

Other Provisions

The Act also:

- Extends the special rule under current law for certain benefits paid by accident or health plans of a public retirement system, to such benefits paid by plans established by or on behalf of a State or political subdivision. It also provides that rule applies to plans funded by trusts that are voluntary employees' beneficiary associations (VEBAs). This provision is effective for payments made after the Act's effective date.

- Provides that, except with respect to statements to partners which are made by partnerships that elect out of the post-2017 partnership audit rule which requires the IRS audit adjustments be made at the partnership level, or as otherwise provided by the IRS, partnerships may not, after the due date of the partnership's Form 1065, Partnership Return, amended the information that they are required to furnish to partners. This provision is generally effective for partnership tax years beginning after December 31, 2017.

This *Hot Topic* is an informative publication for our clients and friends of the Firm. It is designed to provide accurate information on the subject matter covered. We recommend you consult with your legal and other advisors to determine if the information is applicable in your specific circumstances. If these advisors are not available to you, please feel free to contact Barry N. Finkelstein, CPA at 903/473-3540.