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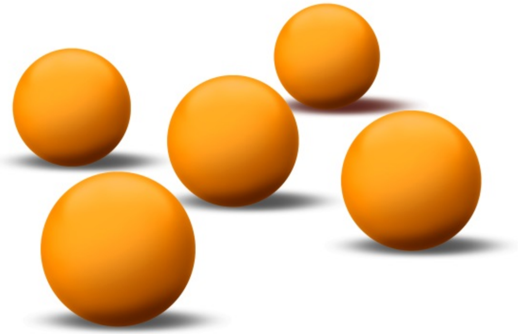

2015 Year End Tax Changes: What You Need to Know Before Your Bowl (Game)

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Just in case they might impact your year-end tax planning, Burr's Tax Section has put together the following summary of recent changes to the tax law; changes which consist of making permanent many of the individual and business tax extenders (provisions previously extended year in and year out on a routine basis by Congress), changes impacting the taxation of REITs, and changes to tax procedure for partnerships and limited liability companies as well as tax filing and penalty rules. While most of these changes come out of last week's tax agreements, the Protecting Americans from Tax Hikes Act (the "Tax Act"), the important procedural changes regarding partnerships were enacted when the Bipartisan Budget Act of 2015 (P.L. 114-74) (the "Budget Act") was signed by the President in November.

New Partnership Audit Rules

In addition to extending the government's debt ceiling through March 15, 2017 and avoiding a federal government shutdown, the Budget Act included changes to the partnership audit rules which will impact almost everyone who is a partner in a partnership. The Budget Act repealed the rules originally enacted in 1982's TEFRA legislation, replacing them with rules that require the assessment of tax items at the entity level; no longer will the IRS have to go through the cumbersome partnership audit rules and assess each partner individually. Under 2015's Budget Act, additional tax, interest and penalties resulting from adjustments made by the IRS will be charged to the partnership. Some well-known commentators have already gone on record to suggest that these new entity level assessment rules will provide partnerships the flexibility to determine which partner(s) will be required to pay any such taxes.

While the new audit rules are designed to apply to all partnerships, those partnerships with 100 or fewer partners are given the opportunity to elect out of the new regime, an election which is irrevocable once made. Although these changes do not become effective until partnership tax years beginning after December 31, 2017, partnerships may elect into the new regime for any tax year beginning after enactment of the Budget Act on November 2, 2015.

The Extenders and Other December Changes

Charitable Remainder Trusts. When a taxpayer wishes to ensure that a property or investment goes to a charity upon the taxpayer's death and still take a charitable deduction in the year that the gift is made, the taxpayer can do so, but only by creating one of the specific "tax approved" types of trusts identified in the Internal Revenue Code. One such "tax approved" trust is a charitable remainder unitrust ("CRUT") which has two variations, a net income only charitable remainder trust ("NICRUT") and a net income with make-up charitable remainder trust ("NIMCRUT"). When a CRUT is created by a taxpayer, the amount of the taxpayer's charitable deduction determined by taking the fair market

value ("FMV") of the corpus and subtracting the value of the unitrust interest (the right to an annual payment of some amount). Should the taxpayer later decide to donate the retained interest to charity, the taxpayer ought to be entitled to a second charitable deduction based upon the FMV of the stream of annual payments transferred to the charity. Prior to this year's Tax Act, valuing a "net income only" and "net income with make-up" interest has been the subject of much discussion between taxpayers and the IRS. The Tax Act brings those valuation disagreements to an end by requiring that the FMV of the annual payments will be determined without regard for any limitation placed on the right to an annual payment; the "net income" and "net income with make-up" limits will henceforth be disregarded.

Deducting State Sales Taxes. For tax years beginning on or after January 1, 2015, the option to deduct state general sales taxes in lieu of state income taxes has been revived; this provision is particularly important to individuals living in states which do not impose a state income tax (e.g., Florida, Tennessee, etc.).

Excluding Gain on Qualified Small Business Stock. The Tax Act also permanently excludes 100% of an individual's gain on qualified small business stock and removes such gain from the individual's Alternative Minimum Tax calculation. Qualified small business stock is stock acquired upon its issue from a corporation (1) which is not an S corporation, (2) at all times has gross assets not exceeding $50,000,000 and (3) uses more than 80% of its assets in the active conduct of a trade or business.

Conservation Easements. For tax years beginning on or after January 1, 2015, the new law allows individuals to deduct the value of a qualified conservation contribution up to 50% of their Adjusted Gross Income ("AGI") and carry over any unused contribution for up to 15 years. Qualified farmers and ranchers may deduct such contributions up to 100% of their taxable income, with a 15 year carryover period. Prior law limited an individual's deduction to 30% of AGI and a corporation's deduction to 10% of its taxable income; both had 5 year carryover periods. The AGI and taxable income deduction limitations are determined after taking into account other allowable charitable contributions.

S Corporations. The Tax Act permanently and retroactively provides for a 5, as opposed to the previous 10, year recognition period for built-in gains. It also retroactively and permanently extends the rule first enacted under the Pension Protection Act of 2006 which provided that an S corporation shareholder only reduces his basis in his stock by his pro rata share of the adjusted basis of corporate property contributed to a charity.

Information Returns. Another Tax Act provision concerns the penalties for failing to furnish correct information returns (Forms 1099, etc.) and payee statements. These penalties were the subject matter of a previous Burr Alert [hyperlink to earlier alert] which discussed the increased penalties for failure to file correct returns and furnish correct payee statements. The new law provides a penalty safe harbor for de minimis errors. If the error is $100 or less ($25 or less if the error involves tax withholding), the party issuing the information return is not subject to a penalty and is not required to file a corrected return. However, a taxpayer may request a corrected payee statement and the de minimis error safe harbor does not apply to any errors on the corrected payee statement.

Reporting Compensation. The new law also mandates that employers now file Forms W-2, W-3, and forms reporting non-employee compensation (e.g., Form 1099-MISC) on or before January 31 of the

year following the calendar year to which such return relates; these forms are no longer eligible for the Section 6071(b) extended filing date for electronic returns. Under the Tax Act's provisions the deadline for furnishing employee or payee statements is now aligned with the filing deadline. Section 6051(a)(2) is also amended to require that an "identifying number" (as opposed to the current "Social Security Number") be included on each W-2, which will allow the Treasury to promulgate regulations permitting or requiring a truncated Social Security Number on Form W-2.

REITs. Like S corporations, REITs also benefit from the reduction of the recognition period for built-in gains from 10 to 5 years. However, as of December 7, 2015 the Tax Act specifically restricts the ability of corporations not already REITs to spin off their real estate assets into a REIT in a transaction which is treated as tax-free under Section 355 by providing that a corporation may not make a REIT election for 10 years after it was involved in a Section 355 transaction. The new law also modifies prior law on the dividend designation and preferential dividend exclusion.

Research and Empowerment Zone Credits. Many popular business tax credits have been extended or made permanent by the Tax Act. The research credit, which previously expired for expenditures paid or incurred after December 31, 2014, is now permanent and, beginning in 2016, may be claimed by certain small businesses against their AMT or payroll tax liability. Empowerment Zone (an economically depressed census tract) tax breaks were extended through 2016; these include the Section 1396 wage credit of 20%, additional Section 179 expensing and phase-out amounts, Section 1394 tax-exempt bond financing, and Section 1397B tax deferral of capital gain on qualified assets sold and replaced. Also extended through 2016 is the Section 179D deduction for a taxpayer's energy-efficient commercial building expenditures. Qualifying expenditures that increase the energy efficiency of climate control, ventilation, hot water, and interior lighting systems are deductible up to $1.80 per square foot of the portion of the property for which the expenditure is made.

New Markets Tax Credit. The New Markets Tax Credit ("NMTC"), which applies to a qualified equity acquisition in a community development entity, was extended through 2019. The NMTC is 5% per year for the first year and first 2 anniversaries of the equity investment (a 15% total credit), plus 6% on each of the next 4 anniversaries thereafter (an additional 24% credit). The carryover period for unused credits is extended through 2024.

Work Opportunity Tax Credit. The expanded Work Opportunity Tax Credit ("WOTC") is retroactively extended through 2019 and provides employers with an income tax credit of 40% of the first $6,000 (first $3,000 in the case of qualified summer youth employees) of first-year wages paid to certain employees. For employees previously unemployed 27 weeks or more, the credit is 40% of the first $10,000 of first-year wages (25% for those working less than 400 hours) and 50% of the first $10,000 of second-year wages. A $6,000 credit is also available for hiring certain veterans, though additional factors including the veteran's term of unemployment, service related disability and start date can increase the credit to as much as $24,000.

Expensing Provisions. The Tax Act permanently and retroactively extends the Section 179 small business expensing limitation of $500,000 and the $2,000,000 phaseout limitation, which previously were $25,000 and $200,000, respectively; these increased amounts are also indexed for inflation for tax years beginning in or after 2016. Computer software is now permanently treated as property subject to Section 179; air conditioning and heating units are also treated as Section 179 property for tax years beginning in or after 2016. Qualified real property, including certain leasehold, restaurant

and retail improvement property, may also be treated as Section 179 property; unused expensing amounts of qualified real property placed may be carried forward for tax years beginning in or after 2016. Bonus depreciation, which allows for an additional percentage of depreciation, is retroactively extended for property placed in service through 2019. Generally, the bonus depreciation percentage, which varies based upon the year in which the property is placed in service, is 50% for 2015 - 2017, 40% for 2018 and 30% for 2019. The Tax Act also increases the Section 280F first-year depreciation limitation for cars and light trucks placed in service during tax years 2016 - 2019.

If you would like more information on the tax impacts of the Act on you or your business, PLEASE CONTACT:

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