ROBERTS, McKENZIE, MANGAN & CUMMINGS, PC

NEWS NOTES

Business Provisions – The Protecting Americans from Tax Hikes Act of 2015

Congress passed and President Obama, on December 18, signed H.R. 2029, the tax (the “Protecting Americans from Tax Hikes Act of 2015” (PATH Act)) and spending bills (Consolidated Appropriations Act, 2016) to fund the government for its 2016 fiscal year. The tax portion includes a two-year delay on taxing high-cost “Cadillac” health plans, as well extensions to several renewable energy credits and a tax break for oil refiners, with tax extenders language making permanent or extending dozens of expired business and household tax breaks. This News Note is the second of four covering these very important provisions. In this News Note, we review some of the major Business Provisions of the PATH Act.

Research Credit Permanently Extended and Made Creditable Against Other Taxes

The research credit equals the sum of: (1) 20% of the excess (if any) of the qualified research expenses for the tax year over a base amount (unless the taxpayer elected an alternative simplified research credit); (2) the university basic research credit (i.e., 20% of the basic research payments); (3) 20% of the taxpayer's expenditures on qualified energy research undertaken by an energy research consortium.

The base amount is a fixed-base percentage of the taxpayer's average annual gross receipts from a U.S. trade or business, net of returns and allowances, for the 4 tax years before the credit year, and can't be less than 50% of the years qualified research expenses. The fixed base percentage for a non-startup company is the percentage (not exceeding 16%) that taxpayer's total qualified research expenses are of total gross receipts for tax years beginning after '83 and before '89. A 3% fixed-base percentage applies for each of the first 5 tax years in which a “startup company” (one with fewer than 3 tax years with both gross receipts and qualified research expenses) has qualified research expenses.

A taxpayer can elect an alternative simplified research credit equal to 14% of the excess of the qualified research expenses for the tax year over 50% of the average qualified research expenses for the three tax years preceding the tax year for which the credit is being determined. If a taxpayer has no qualified research expenses in any one of the three preceding tax years, the alternative simplified research credit is 6% of the qualified research expenses for the tax year for which the credit is being determined. Under pre-Act law, the research credit didn't apply for amounts paid or accrued after Dec. 31, 2014.The Act retroactively and permanently extends the research credit.

Reduction in S Corp Recognition Period for Built-In Gains Tax Permanently Extended

An S corporation generally is not subject to tax, but instead passes through its income to its shareholders, who pay tax on their pro-rata shares of the S corporation's income. Where a corporation that was formed as a C corporation elects to become an S corporation (or where an S corporation receives property from a C corporation in a nontaxable carryover basis transfer), the S corporation is taxed at the highest corporate rate (currently 35%) on all gains that were built-in at the time of the election if the gain is recognized during a recognition period. Under pre-Act law, for S corporation tax years beginning in 2012 and 2013, the recognition

period was five years (instead of the generally applicable 10-year period). Thus, the recognition period was the 5-year period beginning with the first day of the first tax year for which the corporation was an S corporation (or beginning with the date of acquisition of assets if the rules applicable to assets acquired from a C corporation applied). The Act retroactively and permanently provides that, for determining the net recognized built-in gain, the recognition period is a 5-year period—the same rule that applied to tax years beginning in 2014.

Exclusion of 100% of Gain on Certain Small Business Stock Permanently Extended

A taxpayer may exclude all of the gain on the disposition of qualified small business stock acquired after Sept. 27, 2010 and before Jan. 1, 2015. None of the excluded gain is subject to the alternative minimum tax. Under pre-Act law, the exclusion was to be limited to 50% of gain for stock acquired after Dec. 31, 2014, and 7% of the excluded gain was to be an alternative minimum tax preference. The Act retroactively and permanently extends the 100% exclusion and the exception from minimum tax preference treatment.

Lower Shareholder Basis Adjustment for Charitable Contributions by S Corporations Permanently Extended

Before the Pension Protection Act of 2006 (PPA), if an S corporation contributed money or other property to a charity, each shareholder took into account his pro rata share of the fair market value of the contributed property in determining his own income tax liability. The shareholder reduced his basis in his S stock by the amount of the charitable contribution that flowed through to him. The PPA amended this rule to provide that the amount of a shareholder's basis reduction in S stock by reason of a charitable contribution made by the corporation is equal to his pro rata share of the adjusted basis of the contributed property. Under pre-Act law, the PPA rule did not apply for contributions made in tax years beginning after Dec. 31, 2014. The Act retroactively and permanently extends the PPA rule.

Liberal Rule for Corporate Qualified Conservation Contributions Permanently Extended and Expanded

A corporation that, for the tax year of the contribution, is a qualified farmer or rancher and whose stock isn't readily tradable on an established securities market at any time during that year may take a deduction for qualified conservation contributions up to 100% of its taxable income, after taking into account other allowable charitable contributions, 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 Dec. 31, 2014, and contributions made thereafter by corporations can't exceed 10% of its taxable income, with a 5-year carryover of such contributions in excess of the applicable limitation. The Act retroactively and permanently extends the 100% limitation on qualified conservation contributions of real property.

And, for contributions made in tax years beginning after Dec. 31, 2015, the Act provides that Alaska Native Corporations (as defined in section 3(m) of the Alaska Native Claims Settlement Act) are allowed to deduct donations of conservation easements up to 100% of taxable income.

Enhanced Deduction for Food Inventory Permanently Extended and Expanded

A taxpayer engaged in a trade or business is eligible to claim an enhanced deduction for donations of food inventory. A C corporation's deduction equals the lesser of (a) basis plus half of the property's appreciation, or

(b) twice the property's basis, for contributions of food inventory that was apparently wholesome food—i.e., meant for human consumption and meeting certain quality and labeling standards. For a taxpayer other than a C corporation, the aggregate amount of contributions of apparently wholesome food that may be taken into account for the tax year can't exceed 10% of the taxpayer's aggregate net income for that tax year from all trades or businesses from which those contributions were made for that tax year. Under pre-Act law, this enhanced charitable deduction didn't apply for contributions after Dec. 31, 2014. The Act retroactively and permanently extends the apparently wholesome food contribution rules. In addition, for tax years beginning after Dec. 31, 2015,

- . . . The Act increases the limitation on deductible contributions of food inventory from 10% to 15% of the taxpayer's aggregate net taxable income from all trades or businesses from which such contributions were made (15% of taxable income in the case of a C corporation) per year.
- . . . The fair market value (FMV) of apparently wholesome food that cannot or will not be sold solely by reason of internal standards of the taxpayer, lack of market, or similar circumstances is determined without regard to such internal standards, etc.; FMV is determined by taking into account the price at which the same or substantially the same food items—as to both type and quality—are sold by the taxpayer at the time of the contribution.; and
- . . . Taxpayers who do not account for inventories using full absorption costing and who are not required to capitalize indirect costs under the **Code Sec. 263A** UNICAP rules may elect to treat the basis of any apparently wholesome food as being equal to 25% of the market value of the food, in determining the amount of the charitable contribution deduction.

Differential Wage Payment Credit for Employers Permanently Extended and Expanded

Eligible small business employers that pay differential wages—payments to employees for periods that they are called to active duty with the U.S. uniformed services (for more than 30 days) that represent 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. An eligible small business employer is one that: (1) employed on average less than 50 employees on business days during the tax year; and (2) under a written plan, provides eligible differential wage payments to each of its qualified employees. A qualified employee is one who has been an employee for the 91-day period immediately preceding the period for which any differential wage payment is made. Under pre-Act law, the credit was not available for differential wages paid after Dec. 31, 2014. The Act retroactively and permanently extends the credit. And, for tax years beginning after Dec. 31, 2015, the Act provides that the credit applies to employers of any size (i.e., the less than 50 employee average no longer applies).

Work Opportunity Tax Credit Extended Through 2019 and Expanded

The work opportunity tax credit (WOTC) allows employers who hire members of certain targeted groups to get a credit against income tax of a percentage of first-year wages up to $6,000 per employee ($3,000 for qualified summer youth employees). Where the employee is a long-term family assistance (LTFA) recipient, the WOTC is a percentage of first and second year wages, up to $10,000 per employee. Generally, the percentage of qualifying wages is 40% of first-year wages; it's 25% for employees who have completed at least 120 hours, but

less than 400 hours of service for the employer. For LTFA recipients, it includes an additional 50% of qualified second-year wages.

The maximum WOTC for hiring a qualifying veteran generally is $6,000. However, it can be as high as $12,000, $14,000, or $24,000, depending on factors such as whether the veteran has a service-connected disability, the period of his or her unemployment before being hired, and when that period of unemployment occurred relative to the WOTC-eligible hiring date. Under pre-Act law, wages for purposes of the WOTC didn't include any amount paid or incurred to: veterans or non-veterans who began work after Dec. 31, 2014. The Act retroactively extends the WOTC so that it applies to eligible veterans and non-veterans who begin work for the employer before Jan. 1, 2019.

With respect to individuals who begin work for an employer after Dec. 31, 2015, the credit also applies to employers who hire qualified long-term unemployed individuals (i.e., those who have been unemployed for 27 weeks or more). The credit with respect to such long-term unemployed individuals is 40% of the first $6,000 of wages.

New Markets Tax Credit Extended Through 2019

A new markets tax credit applies for qualified equity investments to acquire stock in a community development entity (CDE). The credit is: (1) 5% for the year in which the equity interest is purchased from the CDE and for the first two anniversary dates after the purchase (for a total credit of 15%), plus (2) 6% on each anniversary date thereafter for the following four years (for a total of 24%).

Under pre-Act law, there was a $3.5 billion cap on the maximum annual amount of qualifying equity investments for 2010, 2011, 2012, 2013, and 2014. However, a carryover was allowed where the credit limitation for a calendar year exceeded the aggregate amount allocated for the year, but no amount could be carried over to any calendar year after 2019.The Act retroactively extends the new markets tax credit through 2019. It provides up to $3.5 billion in qualified equity investments for each calendar year from 2015 through 2019. The carryover period for unused new markets tax credits is extended through 2024.

Indian Employment Credit Extended Through 2016

The Indian employment credit is 20% of the excess, if any, of the sum of qualified wages and qualified employee health insurance costs (not in excess of $20,000 per employee) paid or incurred (other than paid under salary reduction arrangements) to qualified employees (enrolled Indian tribe members and their spouses who meet certain requirements) during the tax year, over the sum of these same costs paid or incurred in calendar year '93. Under pre-Act law, the credit didn't apply for any tax year beginning after Dec. 31, 2014. The Act retroactively extends the Indian employment credit for two years to tax years beginning before Jan. 1, 2017.

Please keep in mind that this is only a summary of these new provisions. If you would like to discuss this matter further, please do not hesitate to call.

RMMC 4035 S. Fremont Springfield, MO 65804 (417) 883-5348