

MEMORANDUM

To: Chamber of Commerce Leaders
From: Congressman Jim Gerlach
Date: Tuesday, January 15, 2013
Re: Business provisions included in the fiscal cliff legislation

On January 1st, Congress passed legislation to address the so-called fiscal cliff. In addition to making the 2001 and 2003 tax cuts permanent for 99 percent of taxpayers, the legislation included several business-related tax provisions. I thought this information might be helpful to your membership and have provided information on these provisions below.

Bonus depreciation. Under current law, businesses are allowed to recover the cost of capital expenditures over time according to a depreciation schedule. For 2008 through 2010, Congress allowed businesses to take an additional depreciation deduction allowance equal to 50 percent of the cost of the depreciable property. The TRUIRJCA expanded this provision to allow 100 percent bonus depreciation for investments placed in service after September 8, 2010 and before 2012 and 50 percent bonus depreciation for investments placed in service during 2012. This provision would extend the current 50 percent expensing provision for qualifying property purchased and placed in service before January 1, 2014 (before January 1, 2015 for certain longer-lived and transportation assets) and also allow taxpayers to elect to accelerate some AMT credits in lieu of bonus depreciation. This provision also decouples bonus depreciation from allocation of contract costs under the percentage of completion accounting method rules for assets with a depreciable life of seven years or less that are placed in service in 2013. For regulated utilities, the provision clarifies that it is a violation of the normalization rules to assume a bonus depreciation benefit for ratemaking purposes when a utility has elected not to take bonus depreciation.

15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements. The bill extends for two years, through 2013, the temporary 15-year cost recovery period for certain leasehold, restaurant, and retail improvements, and new restaurant buildings, which are placed in service before January 1, 2014. The extension is effective for qualified property placed in service after December 31, 2011.

Enhanced charitable deduction for contributions of food inventory. The bill extends for two years the provision allowing businesses to claim an enhanced deduction for the contribution of food inventory.

Temporarily extend increase in the maximum amount and phase-out threshold under section 179. Under current law, a taxpayer with a sufficiently small amount of annual investment may elect to deduct the cost of certain property placed in service for the year rather than depreciate those costs over time. The 2003 tax cuts temporarily

increased the maximum dollar amount that may be deducted from \$25,000 to \$100,000. The tax cuts also increased the phase-out amount from \$200,000 to \$400,000. These amounts have been further modified and extended several times on a temporary basis, increasing up to a high of \$500,000 and \$2 million respectively for taxable years beginning in 2010 and 2011, and then to \$125,000 and \$500,000 respectively for taxable years beginning in 2012, before reverting to the permanent amounts of \$25,000 and \$200,000 respectively for taxable years beginning in 2013 and thereafter. The modified proposal would increase the maximum amount and phase-out threshold in 2012 and 2013 to the levels in effect in 2010 and 2011 (\$500,000 and \$2 million respectively). Within those thresholds, the proposal would also allow a taxpayer to expense up to \$250,000 of the cost of qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. This proposal expires at the end of 2013 and the amounts revert to \$25,000 and \$200,000, respectively.

Tax credit for research and experimentation expenses. The bill extends for two years, through 2013, the research tax credit equal to 20 percent of the amount by which a taxpayer's qualified research expenses for a taxable year exceed its base amount for that year and provides an alternative simplified credit of 14 percent. The bill also modifies rules for taxpayers under common control and rules for computing the credit when a portion of a trade or business changes hands.

New Markets Tax Credit. Through the New Markets Tax Credit (NMTTC) program, the federal government is able to leverage federal tax credits to encourage significant private investment in businesses in low-income communities. The program provides a 39 percent tax credit spread over 7 years. The bill extends for two years the new markets tax credit, permitting a maximum annual amount of qualified equity investments of \$3.5 billion each year.

Credit for certain expenditures for maintaining railroad tracks. The bill extends for two years, through 2013, the railroad maintenance credit that provides Class II and Class III railroads (generally, short-line and regional railroads) with a tax credit equal to 50 percent of gross expenditures for maintaining railroad tracks that they own or lease. This credit is allowable against the AMT.

Employer wage credit for activated military reservists. The bill extends for two years, through 2013, the provision that provides eligible small business employers with a credit against the employer's income tax liability for a taxable year in an amount equal to 20 percent of the sum of differential wage payments to activated military reservists.

Work opportunity tax credit. This bill extends for two years, through 2013, the provision that allows businesses to claim a work opportunity tax credit equal to 40 percent of the first \$6,000 of wages paid to new hires of one of eight targeted groups. These groups include members of families receiving benefits under the Temporary

Assistance to Needy Families (TANF) program, qualified ex-felons, designated community residents, vocational rehabilitation referrals, qualified summer youth employees, qualified food and nutrition recipients, qualified SSI recipients, and long-term family assistance recipients.

Returning Heroes and Wounded Warriors Work Opportunity Tax Credits.

Currently businesses are allowed to claim a work opportunity tax credit (WOTC) for hiring qualified veterans in the following targeted groups and up to the following credit amounts:

- Veterans in a family receiving supplemental nutrition assistance: \$2,400
- Short-term unemployed veterans: \$2,400
- Service-related disabled veterans discharged from active duty within a year: \$4,800
- Long-term unemployed veterans: \$5,600
- Long-term unemployed service-related disabled veterans: \$9,600

A credit against Social Security taxes is also available to tax-exempt employers. Transfers are made from general revenues to make the Social Security trust fund whole. The provision expires on December 31, 2012. The proposal would extend these credits for an additional year, though 2013.

Qualified zone academy bonds (QZABs) - allocation of bond limitation. QZABs are a form of tax credit bond which offer the holder a Federal tax credit instead of interest. QZABs can be used to finance renovations, equipment purchases, developing course material, and training teachers and personnel at a qualified zone academy. In general, a qualified zone academy is any public school (or academic program within a public school) below college level that is located in an empowerment zone or enterprise community and is designed to cooperate with businesses to enhance the academic curriculum and increase graduation and employment rates. The provision extends the QZAB program for 2012 and 2013 providing \$400 million in bond volume per year.

Special expensing rules for certain film and television productions. The bill extends for two years, through 2013, the provision that allows film and television producers to expense the first \$15 million of production costs incurred in the United States (\$20 million if the costs are incurred in economically depressed areas in the United States).

Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico. The bill extends for two years the provision extending the section 199 domestic production activities deduction to activities in Puerto Rico.

Modification of tax treatment of certain payments to controlling exempt organizations. In general, interest, rent, royalties, and annuities paid to a tax-exempt organization from a controlled entity are treated as unrelated business income of the

tax-exempt organization. The Pension Protection Act (PPA) provided that if a payment to a tax-exempt organization by a controlled entity is no more than fair market value, then the payment is excludable from the tax-exempt organization's unrelated business income. The bill extends the provision two years to the end of 2013.

Treatment of certain dividends of regulated investment companies (RIC's). The bill extends a provision allowing a RIC, under certain circumstances, to designate all or a portion of a dividend as an "interest-related dividend," by written notice mailed to its shareholders not later than 60 days after the close of its taxable year. In addition, an interest-related dividend received by a foreign person generally is exempt from U.S. gross-basis tax under sections 871(a), 881, 1441 and 1442 of the Code. The proposal extends the treatment of interest-related dividends and short-term capital gain dividends received from a RIC to taxable years of the RIC beginning before January 1, 2014.

RIC qualified investment entity treatment under FIRPTA. The bill extends the inclusion of a RIC within the definition of a "qualified investment entity" under section 897 of the Tax Code through December 31, 2013.

Exceptions under subpart F for active financing income. The U.S. parent of a foreign subsidiary engaged in a banking, financing, or similar business is eligible for deferral of tax on such subsidiary's earnings if the subsidiary is predominantly engaged in such business and conducts substantial activity with respect to such business. The subsidiary must pass an entity level income test to demonstrate that the income is active income and not passive income. The proposal extends the provision to the end of 2013.

Look-through treatment of payments between related controlled foreign corporations under the foreign personal holding company rules. The bill allows deferral for certain payments (interest, dividends, rents and royalties) between commonly controlled foreign corporations (CFC). This provision allows U.S. taxpayers to deploy capital from one CFC to another without triggering U.S. tax. The proposal extends present law to the end of 2013. The proposal is effective for tax years beginning after December 31, 2011.

Special rules for qualified small business stock. Generally, non-corporate taxpayers may exclude 50 percent of the gain from the sale of certain small business stock acquired at original issue and held for more than five years. For stock acquired after February 17, 2009 and on or before September 27, 2010, the exclusion is increased to 75 percent. For stock acquired after September 27, 2010 and before January 1, 2012, the exclusion is 100 percent and the AMT preference item attributable for the sale is eliminated. Qualifying small business stock is from a C corporation whose gross assets do not exceed \$50 million (including the proceeds received from the issuance of the stock) and who meets a specific active business requirement. The amount of gain eligible for the exclusion is limited to the greater of ten times the taxpayer's basis in the stock or \$10 million of gain from stock in that

corporation. The provision extends the 100 percent exclusion of the gain from the sale of qualifying small business stock that is acquired before January 1, 2014 and held for more than five years. The bill also clarifies that in the case of stock acquired after February 17, 2009, and before January 1, 2014, the date of acquisition for purposes of determining the percentage exclusion is the date the holding period for the stock begins.

Basis adjustment to stock of S corporations making charitable contributions of property. The bill extends for two years the provision allowing S corporation shareholders to take into account their pro rata share of charitable deductions even if such deductions would exceed such shareholder's adjusted basis in the S corporation.

Reduction in S corporation recognition period for built-in gains tax. If a taxable corporation converts into an S corporation, the conversion is not a taxable event. However, following such a conversion, an S corporation must hold its assets for a certain period in order to avoid a tax on any built-in gains that existed at the time of the conversion. The American Recovery and Reinvestment Act reduced that period from 10 years to 7 years for sales of assets in 2009 and 2010. The Small Business Jobs Act reduced that period to 5 years for sales of assets in 2011. The bill extends the reduced 5-year holding period for sales occurring in 2012 and 2013. In addition, this bill clarifies rules for carryforwards and installment sales.

Empowerment zone tax incentives. The bill extends for two years the designation of certain economically depressed census tracts as Empowerment Zones. Businesses and individual residents within Empowerment Zones are eligible for special tax incentives.