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PATH ACT EXTENDS TAX RELIEF FOR INDIVIDUALS AND BUSINESSES — AND MAKES SOME BREAKS PERMANENT

Congress passed a new wide-ranging law on December 18 that extended many expired tax breaks. The President immediately signed the Protecting Americans from Tax Hikes Act of 2015 (the PATH Act). The new law does more than just extend expired tax provisions for another year. It makes many popular tax breaks permanent or extends them for two to five years.

In doing so, the PATH Act provides some stability in planning. When it comes to certain deductions and credits, taxpayers will no longer have to wait for Congress to pass a temporary tax extenders law — often at the last minute — in order to plan tax-saving strategies.

Here's an overview of how individuals and businesses can benefit from the latest tax package.

TAX BREAKS FOR INDIVIDUALS

American Opportunity credit. Eligible taxpayers can take an annual credit of up to $2,500, for various tuition and related expenses, for each of the first four years of postsecondary education. The credit phases out based on modified adjusted gross income (MAGI) beginning at $80,000 for single filers and $160,000 for joint filers, indexed for inflation. The new law makes this credit permanent.

Tuition and fees deduction. The new law extends through 2016 the above-the-line deduction for qualified tuition and related expenses for higher education. The deduction is capped at $4,000 for taxpayers whose adjusted gross income (AGI) doesn't exceed $65,000 ($130,000 for joint filers) or, for those beyond those amounts, $2,000 for taxpayers whose AGI doesn't exceed $80,000 ($160,000 for joint filers).

Small business stock gains exclusion. The PATH Act makes permanent the exclusion of 100% of the gain on the sale or exchange of qualified small business (QSB) stock acquired and held for more than five years. The 100% exclusion is available for QSB stock acquired after September 27, 2010.

A QSB is generally a domestic C corporation that has gross assets of no more than $50 million at any time (including when the stock is issued) and uses at least 80% of its assets in an active trade or business. The law also permanently extends the rule that eliminates QSB stock gain as a preference item for alternative minimum tax (AMT) purposes.

Charitable giving from IRAs. The PATH Act makes permanent the provision that allows taxpayers who are age 70½ or older to make direct contributions from their IRAs to qualified charitable organizations up to $100,000 per tax year. If you take advantage of this opportunity, you can't claim a charitable or other deduction for the contributions, but the amounts aren't considered taxable income and can be used to satisfy your required minimum distributions.

To qualify for the exclusion from income for IRA contributions for a tax year, you need to arrange a direct transfer by the IRA trustee to an eligible charity by December 31. Donor-advised funds and supporting organizations aren't eligible recipients.

State and local sales tax deduction. Taxpayers can take an itemized deduction for state and local sales taxes, instead of for state and local income taxes. This tax break is now permanent. The deduction is especially valuable for individuals who live in states without income taxes and those who purchase major items, such as a car or boat.

Energy tax credit. The PATH Act extends through 2016 the credit for purchases of residential energy property. Examples include new high-efficiency heating and air conditioning systems, insulation, energy-efficient exterior windows and doors, high-efficiency water heaters and stoves that burn biomass fuel.

The provision allows a credit of 10% of expenditures for qualified energy improvements, up to a lifetime limit of $500.

Mortgage-related tax breaks. Under the new law, you can treat qualified mortgage insurance premiums as interest for purposes of the mortgage interest deduction through 2016. However, the deduction phases out for taxpayers with AGIs of $100,000 to $110,000.

In addition, the PATH Act extends through 2016 the exclusion from gross income for mortgage loan forgiveness. It also modifies the exclusion to apply to mortgage forgiveness that occurs in 2017 as long as it's granted pursuant to a written agreement entered into in 2016.

Educator expense deductions. Qualifying elementary and secondary school teachers can 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 the new law, beginning in 2016, the deduction is indexed for inflation and includes professional development expenses.

TAX BREAKS FOR BUSINESSES

Section 179 deduction. Tax law allows businesses to elect to immediately deduct — or expense — the cost of certain tangible personal property acquired and placed in service during the tax year. This is in lieu of recovering the costs more slowly through depreciation deductions. Keep in mind the election can only offset net income — it can't reduce it below $0 to create a net operating loss.

The election is also subject to annual dollar limits. For 2014, businesses could expense up to $500,000 in qualified new or used assets, subject to a dollar-for-dollar phaseout once the cost of all qualifying property placed in service during the tax year exceeded $2 million. Without the PATH Act, the expensing limit and the phaseout amounts for 2015 would have sunk to $25,000 and $200,000, respectively.

The new law makes the higher limits permanent, indexing them for inflation beginning in 2016. It also makes permanent the ability to apply Sec. 179 expensing to qualified real property, reviving the 2014 limit of $250,000 on such property for 2015 but raising it to the full Sec. 179 limit beginning in 2016. Qualified real property includes qualified leasehold-improvement, restaurant and retail-improvement property.

Finally, the new law permanently includes off-the-shelf computer software on the list of qualified property. And, beginning in 2016, it adds air conditioning and heating units.

Bonus depreciation. Bonus depreciation allows businesses to recover the costs of depreciable property more quickly by claiming bonus first-year depreciation for qualified assets. It's been extended, but only through 2019 and with declining benefits in the later years. For property placed in service during 2015, 2016 and 2017, the bonus depreciation percentage is 50%. It drops to 40% for 2018 and 30% for 2019.

The provision continues to allow businesses to claim unused AMT credits in lieu of bonus depreciation.

Beginning in 2016, the amount of unused AMT credits that may be claimed increases.

Qualified assets include new tangible property with a recovery period of 20 years or less (such as office furniture and equipment), off-the-shelf computer software, water utility property and qualified leasehold-improvement property. Beginning in 2016, qualified improvement property doesn't have to be leased to be eligible for bonus depreciation.

Accelerated depreciation of qualified real property. The PATH Act permanently extends the 15-year straight-line cost recovery period for qualified leasehold improvements (building alterations to suit the needs of a tenant), qualified restaurant property and qualified retail-improvement property. These expenditures are now exempt from the normal 39-year depreciation period.

This is beneficial for restaurants and retailers because they tend to remodel periodically. If eligible, they may first apply Sec.179 expensing and then enjoy this accelerated depreciation on qualified expenses in excess of the applicable Sec. 179 limit.

Research credit. This valuable credit provides an incentive for businesses to increase their investments in research. However, the temporary nature of the credit deterred some businesses from pursuing critical innovations.

The PATH Act permanently extends the credit. Additionally, beginning in 2016, businesses with $50 million or less in gross receipts can claim the credit against AMT liability, and certain start-ups (generally, those with less than $5 million in gross receipts) that haven't yet incurred income tax liability can use the credit against their payroll tax.

Work Opportunity credit. Employers that hire individuals who are members of a "target group" can claim this credit, which has been extended through 2019. The new law also expands the credit beginning in 2016 to apply to employers that hire qualified individuals who have been unemployed for 27 weeks or more.

The credit amount varies depending on the:

- Target group of the individual hired,
- Wages paid to the employee
- Hours worked by the new hire during the first year of employment

The maximum tax credit that can be earned for each qualified adult employee is generally $2,400. The credit can be as high as $9,600 per qualified veteran. Employers aren't subject to a limit on the number of eligible individuals they can hire.

You must obtain certification that an employee is a member of a target group from the appropriate State Workforce Agency before claiming the credit. The certification must be requested within 28 days after the employee begins work.

Food inventory donations. The PATH Act makes permanent the enhanced deduction for contributions of food inventory for noncorporate business taxpayers. Under the enhanced deduction (which is already permanently available to C corporations), the lesser of basis plus one-half of the item's appreciation or two times basis can be deducted, rather than only the lesser of basis or fair market value. Beginning in 2016, the limit on deductible contributions of inventory increases from 10% to 15% of the business's AGI per year.

S corporation recognition period for built-in gains tax. S corporation income generally is passed through to its shareholders, who pay tax on their pro-rata shares. If a C corporation elects to become an S corporation, the newly created S corporation is taxed at the highest corporate rate (currently 35%) on all gains that were built-in at the time of the election and recognized during the "recognition period." Generally, this period is 10 years. But, under the new law, it's only five years, beginning on the first day of the first tax year for which the corporation was an S corporation.

Commuting fringe benefits. The PATH Act makes permanent the provision that established equal limits for the amounts that can be excluded from an employee's wages for income and payroll tax purposes for parking fringe benefits and van-pooling / mass transit benefits. The limits for both types of benefits are now $250 per month for 2015 (increasing to $255 for 2016). Without the parity extension, the limit for van-pooling / mass transit would be only $130.

"Cadillac Tax" delay. A related new law delays the start of the so-called "Cadillac" tax on high-cost employer-provided health insurance from 2018 to 2020. The 40% tax, under the Affordable Care Act, would be applied to health coverage that costs more than $10,200 for individuals and $27,500 for families, with annual threshold increases based on inflation. The tax would be assessed on the difference between the total cost of health benefits for an employee in a year and the applicable threshold amount.

Medical device tax. The PATH Act halts the 2.3% excise tax on the sale of medical devices in 2016 and 2017.

TAX PLANNING WITH MORE CERTAINTY

Under the PATH Act, there are now significant tax planning opportunities for individuals and businesses. The permanent extensions of some valuable tax breaks will make it easier for taxpayers to plan ahead. Keep in mind this article touches on only some of the new law's provisions. There may be other extensions and enhancements that can benefit individuals and businesses.

Contact your tax advisor to determine how you can make the most of this tax relief.

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