American Taxpayer Relief Act of 2012
Old Opportunities For Tax Planning Made Permanent or Extended; New Opportunities Created

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American Taxpayer Relief Act of 2012
Highlights

Income Tax Rates:	Permanent Extension of 2001 income tax rates for single taxpayers' income below $400,000 ($425,000 for heads of households; $450,000 for married filing jointly); 39.6% rate for taxable income above $400,000 ($425,000; $450,000)
Capital Gains:	Permanent Extension of the 15% capital gain rate for single taxpayers' income below $400,000 ($425,000 for heads of households; $450,000 for married filing jointly); 20% rate for taxable income above $400,000 ($425,000; $450,000)
Qualified Dividends:	Permanent Extension of the 15% income tax rate for single taxpayers' income below $400,000 ($425,000 for heads of households; $450,000 for married filing jointly); 20% rate for taxable income above $400,000 ($425,000; $450,000)
Alternative Minimum Tax Exemptions:	Permanent Extension of 2011 exemptions with indexing for inflation
Phase Out of Itemized Deductions:	Itemized deductions reduced by three cents for every dollar of single taxpayers' taxable income in excess of $250,000 ($275,000 for heads of households; $300,000 for married filing jointly)
Personal Exemption Phase Out:	Personal exemptions reduced by two percent for each $2,500 (or portion thereof) of single taxpayers' income above $250,000 ($275,000 for heads of households; $300,000 for married filing jointly)
Investment Incentives:	Elective expensing of up to $500,000 of depreciable assets used in a trade or business; 50% bonus depreciation for assets not expensed.
Payroll Tax Reduction:	Eliminated
Estate, Gift, and Generation Skipping Transfer Tax Rates:	Increase to 40% for gifts made and decedents dying after 2012
Gift, Estate, and Generation Skipping Transfer Tax Exemptions:	$5 million dollars (inflation-adjusted) for gifts made and decedents dying after 2010; 2013 exemption: $5,250,000

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H.R. 8, the American Taxpayer Relief Act of 2012 (the "2012 Act") was passed by the Senate and by the House of Representatives on January 1, 2013. The 2012 Act was signed into law by President Barrack Obama on January 2, 2013.

Title I: Permanent Extension of Tax Relief

SECTION 101: PERMANENT EXTENSION AND MODIFICATION OF 2001 TAX RELIEF

The 2012 Act extends income tax rate reductions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub. L. No. 107-16) ("EGTRRA") for taxpayers with taxable income below certain thresholds: $400,000 for single taxpayers; $425,000 for heads of households; $450,000 for married filing jointly. For taxable years beginning after 2013 brackets are adjusted in multiples of $50 for cost of living adjustments using 2012 as the base year.

Individual Income Tax Rate Reductions. EGTRRA reduced marginal income tax rates for most taxpayers. A 10% income tax bracket was created for taxable income previously taxed at 15%. The 28%, 31%, 36%, and 39% brackets were reduced, respectively to 25%, 28%, 33%, and 35%. Subject to inflation adjustments, the EGTRRA rate structure is extended indefinitely by the 2012 Act for taxable income below the thresholds noted above. 2013 rates for single taxpayers and married persons filing jointly are set forth below.

Table 1.- Federal Individual Income Tax Rates for 2013

If taxable income is:	The income tax equals:
Single Individuals	
Not over $8,925	10% of taxable income
Over $8,925 but not over $36,250	$892.50 plus 15% of the excess over $8,925
Over $36,250 but not over $87,850	$4,991.25 plus 25% of the excess over $36,250
Over $87,850 but not over $183,250	$17,891.25 plus 28% of the excess over $87,850
Over $183,250 but not over $398,350	$44,603.25 plus 33% of the excess over $183,250
Over $398,350 but not over $400,000	$115,586.25 plus 35% of the excess over $398,350
Over $400,000	$116,163.75 plus 39.6% of the excess over $400,000
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $17,850	10% of taxable income
Over $17,850 but not over $72,500	$1,785 plus 15% of the excess over $17,850
Over $72,500 but not over $146,400	$9,982.50 plus 25% of the excess over $72,500
Over $146,400 but not over $223,050	$28,457.50 plus 28% of the excess over $146,400
Over $223,050 but not over $398,350	$49,919.50 plus 33% of the excess over $223,050
Over $398,350 but not over $450,000	$107,768.50 plus 35% of the excess over $398,350
Over $450,000	$125,846 plus 39.6% of the excess over $450,000

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Effective Date: The provision applies to the taxable years beginning after December 31, 2012.

IRC Section Affected: Internal Revenue Code ("IRC") Section 1.

Planning Note: *Social Security and Medicare Taxes.* There is more than just income tax. Income may also be subject to social security and Medicare taxes (depending upon the character of the income). For example, in 2013 the first $113,700 of earned income is subject to a social security tax of 6.2% (of which half is paid by employers) and a Medicare tax of 2.9% (of which 1.45% is paid by employers). In the case of self-employed individuals (including general partners) the entire social security and Medicare tax is borne by the individual taxpayer.

Starting in 2013, earned income in excess of $200,000 for single individuals and $250,000 for taxpayers who are married and file joint returns will be subject to an additional 0.9% Medicare tax (of which 0.45% is paid by the employer) under IRC Section 1411(a). In the case of income from investments (including, in most cases, rental real estate) and passive income of a trade or business, income in excess of $200,000 for single individuals and $250,000 for married persons who file joint returns will be subject to an additional 3.8% Medicare tax to the extent of the lesser of (a) the amount of portfolio and passive income and (b) the amount of modified adjusted gross income in excess of the $200,000 and $250,000 thresholds. The impact of social security and Medicare taxes is illustrated by the table below.

<table>
<tr><th colspan="2">Taxable Income
(Modified Adjusted Gross Income)
(Gross Income)</th><th colspan="5">Tax Rates</th></tr>
<tr><th>Single Individuals</th><th>Married Filing Joint and Surviving Spouse</th><th>Ordinary Income Tax Rate</th><th>Capital Gain and Dividend Tax Rate</th><th>Medicare Tax on Earned Income</th><th>Additional Medicare Tax on Investment Income</th><th>Social Security Tax</th></tr>
<tr><td>$0+</td><td>$0+</td><td>10%</td><td rowspan="2">0%</td><td rowspan="6">1.45%
(*2.9%)</td><td rowspan="6">0%</td><td rowspan="5">6.2%
(*12.4%)</td></tr>
<tr><td>$8,925+</td><td>$17,850</td><td>15%</td></tr>
<tr><td>$36,250+</td><td>$72,500</td><td>25%</td><td rowspan="6">15%</td></tr>
<tr><td>$87,850+</td><td>(GI) $113,700+</td><td rowspan="2">28%</td></tr>
<tr><td>(GI) $113,700+</td><td>$146,400+</td></tr>
<tr><td>$183,250+</td><td>$223,050+</td><td rowspan="2">33%</td><td rowspan="4">0%</td></tr>
<tr><td>(MAGI) $200,000+</td><td>(MAGI) $250,000+</td><td rowspan="3">1.85%
(*3.8%)</td><td rowspan="3">3.8%</td></tr>
<tr><td>$398,350+</td><td>$398,350+</td><td>35%</td></tr>
<tr><td>$400,000+</td><td>$450,000+</td><td>39.6%</td><td>20%</td></tr>
<tr><td colspan="7">*Self Employed</td></tr>
</table>

Planning Note: *Choice of entity considerations.* Lower maximum corporate income tax rates than those imposed on individuals combined with a 100% exclusion for gain realized on sale of qualified small business stock under IRC Section 1202 may merit reconsideration (and perhaps conversion) of businesses conducted by pass-through entities to C corporations. Such a decision

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appears to be most appropriate for businesses with relatively modest amounts of taxable income ($100,000 or less). Income taxed to the corporation at the 15% rate (the first $50,000 of taxable income) could be distributed net of the corporate tax to the shareholders as a qualified dividend taxable at either the 15 or 20% rate. The effective tax rate on this income could be as low as 27.5%. C corporation status may also be attractive for a highly profitable business whose earnings are reinvested in the business for capital appreciation realized on sale of the corporation's stock. In such a case, the effective rate of taxation on the income of the corporation would be at most 35% (in the case of taxable income in excess of $10,000,000 in any given year) and more likely 34%, with no tax paid on sale of stock qualifying for the IRC Section 1202 exclusion.

Planning Note: *Choice of entity considerations.* Perhaps it is an oversight to be addressed in a subsequent technical correction act, but the 2012 Act did not amend IRC Section 11(c)(2) which imposes a flat rate of 35% on the taxable income of qualified personal service corporations. A "qualified personal service corporation" is defined by IRC Section 448(d)(2) as a corporation performing services in the fields of health, law, engineering, architecture, accounting, actual science, performing arts, and consulting if substantially all the corporation's stock is held directly or indirectly by current or retired employees performing such services. C corporations engaged in personal service activities may be perceived as advantageous because of

- a lower maximum tax rate than that imposed on the income of the shareholders who own the stock of the qualified personal service corporation and

- exemption of the qualified personal service corporation from the requirement of IRC Section 448(a) to use the accrual method of accounting when average gross receipts for the prior three prior years exceed $5,000,000.

Limitation on Itemized Deductions and Phase Out of Personal Exemptions. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Pub. L. No. 111-312) (the "2010 Act") eliminated the phase out of personal exemptions and limitations on itemized deductions which had been a pre-EGTRRA feature of the revenue laws. The 2012 Act restores both limitations at thresholds of $250,000 for single individuals, $275,000 for heads of households, and $300,000 for married filing jointly. Starting in 2013, adjusted gross income in excess of these thresholds will reduce the taxpayer's itemized deductions by 3% of the excess amount. Similarly, the deduction for personal exemptions ($3,900 for 2013) will be reduced by 2% for each $2,500 (or any portion thereof) of adjusted gross income in excess of the same thresholds. The threshold amount will be adjusted in multiples of $50 for inflation, using 2012 as the base year.

Effective Date: Taxable years beginning after December 31, 2012.

IRC Sections Affected: IRC Sections 68 and 151.

Planning Note: *Effective Tax Rates.* The combination of increased income tax rates, 2013 effective Medicare tax rate increases, and phase outs of itemized deductions and personal exemptions will cause marginal rates of high income taxpayers to approach 50%. Even if 2012 Act

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rates remain "permanent," year-end tax planning and accurate tax projections will be crucial to determine the best year for taxpayers to recognize income and claim deductions.

Marriage Penalty Relief. EGTRRA increased the standard deduction for married persons filing joint returns to twice the amount of the standard deduction for single taxpayers and increased the size of the 15% income tax bracket for married persons filing joint returns to twice the size of the 15% bracket for a single taxpayer. The 2012 Act extends both of these marriage penalty relief provisions indefinitely.

Effective Date: Taxable years beginning after December 31, 2012.

IRC Sections Affected: IRC Sections 1(f)(8) and 63(c)(2).

Planning Note: *Think twice about getting married.* Doubling the size of the standard deduction and increasing the size of the 15% bracket for married taxpayers filing jointly relative to single individuals notwithstanding, the tax penalty for marriage is still severe. The combined tax liability for two single individuals each earning $400,000 is $232,327.50. In contrast, if the single taxpayers marry the liability is $246,946, an increase of $14,618.50.

Permanent Extension of Estate, Gift, and Generation-Skipping Transfer Tax Exemptions and Portability and Modification of Estate, Gift, and Generation-Skipping Transfer Tax Rates. EGTRRA phased out estate and generation-skipping transfer taxes by decreasing the maximum Federal estate tax rate from 55% to 45%, increasing the estate and generation-skipping transfer tax exemptions from $1 million to $3.5 million, and ultimately repealing the Federal estate and generation-skipping transfer taxes for decedents dying in 2010. The 2010 Act further reduced the maximum gift, estate, and generation-skipping transfer tax rates to 35% and increased the exemptions for each of these transfer taxes to $5 million (indexed for inflation). The 2012 Act increases the maximum gift, estate, and generation-skipping transfer tax rates from 35% to 40% but extends indefinitely the $5 million exemption (retaining the inflation adjustment). As a result, all three exemptions increase to $5,250,000 for gifts made and decedents dying in 2013.

Effective Date: Applies to estates of decedents dying and transfers made after December 31, 2012.

IRC Sections Affected: IRC Sections 2001 and 2010.

Planning Note: *Income-shifting opportunity.* Increased individual income tax rates combined with a gift tax exemption of $5,250,000 create a significant opportunity for wealthy individuals to transfer income-producing assets to family members who are in lower income tax brackets. It was commonly believed that the reason the gift tax was retained with a $1 million exemption in EGTRRA's phase out and repeal of estate and generation-skipping transfer taxes was to protect the efficacy of the income tax system. Since 2011 a wealthy taxpayer has been able to transfer up to $5 million in assets to family members whose income is taxed at a lower marginal rate than the income of the transferor without paying a gift tax, thereby gaining a powerful arbitrage of income tax rates.

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Planning Note: *Indexing creates opportunity for additional gifts.* Even taxpayers who took full advantage of last year's gift tax exemption of $5,120,000 out of concern it would expire to a pre-2011 level of $1 million can make an additional $130,000 in gifts in 2013 without incurring a gift tax (and after exhaustion of 2013 annual exclusions which have been inflation-adjusted to $14,000 per recipient).

Planning Note: *Do not be confused.* The gift and estate tax exemptions are based upon a single unified credit. As a result, gifts of $5 million not only reduce the transferor's remaining gift tax exemption from $5,250,000 to $250,000, the estate tax exemption available to the estate of that transferor is also reduced to $250,000. Similarly, to the extent that the transferor's generation-skipping transfer tax exemption was allocated to lifetime gifts, the remaining generation-skipping transfer tax exemption available at the transferor's death is also reduced to $250,000.

Planning Note: *State Estate Taxes.* Despite permanent extension of the estate tax exemption at $5,000,000 by the United States Congress, state legislatures have not been as generous. For example, the District of Columbia, Maryland, Massachusetts, Minnesota, New York, and Oregon have all frozen the state estate tax exemption at $1,000,000. Generally, state estate taxes are imposed at rates of between 5% and 16%. For example, in Maryland, the state estate tax on a $1,500,000 estate after allowance for the exemption is $64,400. The Maryland state estate tax after allowance for a $1,000,000 exemption in the case of a $2,000,000 estate is $99,600.

The posthumous transfer of a unified credit between spouses ('portability"). The 2010 Act introduced the concept of gift and estate tax exemption portability between spouses. That is, the unused unified credit of the first spouse to die (the "deceased spouse") is available to the surviving spouse if an election is made on the deceased spouse's Federal estate tax return. If the surviving spouse has survived two spouses, both of whose executors made the election, only the unused exemption of the last deceased spouse is available to the surviving spouse. The election must be made by the executor of the deceased spouse's estate on a timely filed estate tax return. The 2012 Act also makes portability permanent and conforms the statutory language of IRC Section 2010(c)(4)(B)(i) to the legislative history.

Effective Date: Estates of decedents dying and transfers made after December 31, 2012.

IRC Sections Affected: IRC Section 2010(c)

Planning Note*:* *Selecting the most appropriate use of the deceased spouse's estate tax exemption.* Despite the attempt at simplification which portability of the gift and estate tax exemption provides, it will still be important to use a bypass trust in many cases. This is true for three reasons. First, the deceased spouse's unused unified credit is not indexed for inflation. Consequently, assets inherited from the deceased spouse by the surviving spouse may continue to increase in value without shelter of the appreciation from estate taxation at the death of the surviving spouse. In contrast, if the inherited assets were captured by a bypass trust, appreciation between the death of the first spouse and the death of the survivor will escape estate taxation. Second, portability is not provided for the deceased spouse's unused generation-skipping transfer tax exemption.

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Absent creation of a bypass trust (or other trust to which the deceased spouse's generation-skipping transfer tax exemption is allocated), all of the generation-skipping transfer tax exemption of the deceased spouse will be lost. Finally, for decedents dying in states with a state estate tax, assets inherited from the deceased spouse will often be subject to higher marginal state estate tax rates at the death of the surviving spouse than if those assets had been subjected to state estate taxation at the deceased spouse's death.

Planning Note: *The Opportunity for a Second Basis Increase for the Deceased Spouse's Assets.* The potential pitfalls for the reliance on portability notwithstanding, the ability to defer estate tax until the death of the surviving spouse (through use of the marital deduction by the deceased spouse's estate) coupled with portability of the deceased spouse's estate tax exemption for use at the survivor's death allows the assets inherited by the surviving spouse to receive a second basis adjustment at the death of the surviving spouse. In contrast, the appreciation which occurs in assets held by a bypass trust between the death of the deceased spouse and the death of the surviving spouse is not reflected in the basis of those assets because the bypass trust excludes the assets it holds from inclusion in the gross estate of the surviving spouse. Although this "protection" from estate taxation at the death of the surviving spouse may be desirable for the reasons explained above, it carries with it a disadvantage in that those assets might have been subject to inclusion in the surviving spouse's gross estate and fully sheltered from estate taxation at the surviving spouse's death through the combination of the deceased spouse's estate tax exemption and the surviving spouse's estate tax exemption.

SECTION 102: PERMANENT EXTENSION AND MODIFICATIONOF 2003 TAX RELIEF

Capital Gain and Qualified Dividends. The Jobs and Growth Tax Relief Act of 2003 (the "2003 Act") reduced the maximum tax rate on adjusted net capital gains realized by individual taxpayers from 20% to 15%. It also reduced the tax rate for adjusted net capital gains of low-income taxpayers (which absent the 2003 Act would be taxed at 10% or 15% rates) to a rate of 0%. These rates apply for both regular and alternative minimum tax purposes.

The 2003 Act also reduced the tax rate on qualified dividend income from the ordinary income tax rates to which it was traditionally subject to the same rates the 2003 Act applied to adjusted net capital gains: 0% and 15%. The reduced tax rates on qualified dividends apply for both regular and alternative minimum tax purposes.

The 2012 Act extends the 15% tax rate on qualified dividends and adjusted net capital gains indefinitely for taxpayers whose taxable income (including net capital gains) is below the 39.6% bracket ($400,000 for single individuals; $425,000 for heads of households; $450,000 for married filing jointly).

Effective Date: Taxable years beginning after 2012.

IRC Sections Affected: IRC Sections 1(h) and 55.

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SECTION 103: 5-YEAR EXTENSION OF 2009 TAX RELIEF

American Opportunity Tax Credit. The 2012 Act extends the American Opportunity Tax Credit for five years. The 2012 Act also increases the threshold at which the American Opportunity Tax Credit begins to be phased out from $80,000 to $90,000 (and from $160,000 to $180,000 for married persons filing joint returns).

The American Recovery and Reinvestment Tax Act of 2009 (Pub. L. No. 111-5) (the "2009 Act") created the American Opportunity Tax Credit which is, in effect, an enhancement of the Hope Scholarship Credit. The 2009 Act made several changes to the Hope Scholarship Credit (the "Hope Credit").

- The maximum amount of the Hope Credit was increased from $2,000 per year to $2,500.
- The computation of the Hope Credit was changed so that the amount which may be claimed in any taxable year is 100% of the "qualified tuition and related expenses" paid by the taxpayer during the taxable year up to $2,000 plus 25% of such expenses in excess of $2,000 but not exceeding $4,000.
- The number of years in which the Hope Credit may be claimed for post-secondary education was increased from 2 years to 4 years.
- Required course materials were expressly included within the term "qualified tuition and related expenses."
- The Hope Credit may be claimed against the taxpayer's alternative minimum tax liability.
- 40% of the Hope Credit was made refundable if the taxpayer is *not* a child to whom the "kiddie tax" of IRC Section 1(g) applies.

Effective Date: Taxable years beginning after 2012.

IRC Section Affected: IRC Section 25A(i).

Sunset Date: December 31, 2017.

Child Tax Credit. For both regular and alternative minimum tax purposes, individual taxpayers may claim a $1,000 tax credit for each qualified child under the age of seventeen. The aggregate amount of child tax credits is phased out by $50 for each $1,000 of modified adjusted gross income over $110,000 for married individuals filing joint returns, $75,000 for single individuals or heads of households, and $55,000 for married individuals filing separate returns. EGTRRA made a portion of the child tax credit refundable if the child tax credit exceeds the taxpayer's tax liability by an amount equal to 15% of earned income in excess of $10,000. The 2009 Act reduced the $10,000 threshold to $3,000. In the case of families with three or more qualified

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children, the refundable credit can be determined using an alternate formula that measures the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income tax credit. The 2010 Act extended the taxpayer-friendly amendments of the 2009 Act for two years.

The 2012 Act extends favorable provisions of prior legislation for five years and

(1) prevents the reduction in the $1,000 child tax credit to $500,

(2) allows the child tax credit to be claimed for both regular and alternative minimum tax purposes,

(3) prevents reduction of the refundable credit by the alternative minimum tax liability,

(4) freezes the earned income threshold at $3,000 without inflation adjustments,

(5) extends the availability of the alternate formula for computing the refundable credit, and

(6) extends the treatment that the refundable portion of the child tax credit is not taxable as income and is not treated as an available resource for purposes of determining eligibility under Federal programs providing assistance to low income individuals and families or state or local programs financed with Federal funds.

Effective Date: Taxable years beginning after 2012

IRC Sections Affected: IRC Sections 24 and 26.

Sunset Date: December 31, 2017.

Earned Income Tax Credit. The 2009 Act enhanced the earned income tax credit by allowing taxpayers with three or more qualifying children to claim a credit of 40% of qualifying earned income for 2009 and 2010. The 2010 Act increased the threshold at which the earned income tax credit begins to be phased out from $3,000 to $5,000. The 2010 Act extended the 45% rate for computation of the credit and the higher phase out threshold for married persons filing joint returns for two years. The 2012 Act extends these provisions for five years.

Effective Date: Applies to taxable years beginning after December 31, 2012.

IRC Section Affected: IRC Sections 32(b)(3).

Sunset Date: December 31, 2017.

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SECTION 104: PERMANENT EXTENSION OF INCREASED ALTERNATIVE MINIMUM TAX EXEMPTION AMOUNT AND ALTERNATIVE MINIMUM TAX RELIEF FOR NONREFUNDABLE PERSONAL TAX CREDITS

Alternative Minimum Tax Exemption. The 2012 Act extends indefinitely prior increases of the AMT exemption and indexes the exemption for inflation. Relief is made retroactive to 2012. The AMT exemption is set at $50,600 for single individuals and heads of households and $78,750 for married taxpayers filing jointly. These amounts are adjusted for increases in inflation for calendar years after 2012 using 2011 as the base year. Expected exemptions for 2013 will be $51,900 for unmarried taxpayers and $80,750 for married taxpayers filing jointly.

Effective Date: Applies to taxable years beginning after December 31, 2011.

IRC Section Affected: IRC Section 55(d).

Nonrefundable Personal Tax Credits. Prior to 2010, the tax credits set forth in IRC Sections 21 through 25D (referred to as "Nonrefundable Personal Tax Credits") were deductible for regular as well as alternative minimum tax purposes. Prior to amendments made by the 2010 Act, many of the Nonrefundable Personal Credits (for example, the dependent care credit of IRC Section 21, the credit for the elderly and permanently disabled under IRC Section 22, the credit for interest on certain home mortgages under IRC Section 25, the hope scholarship (American opportunity) and lifetime learning credits under IRC Section 25A, the nonbusiness energy property credit under IRC Section 25C, and the residential energy efficient property credit under IRC Section 25D) would only be allowed to the extent the taxpayer's regular tax liability exceeded the alternative minimum tax liability. The 2012 Act makes permanent the full allowance of all Nonrefundable Personal Tax Credits for both regular and alternative minimum tax purposes.

Effective Date: Applies to taxable years beginning after December 31, 2011.

IRC Section Affected: IRC Section 26(a)(2).

<u>Title II: Individual Tax Extenders</u>

The 2012 Act retroactively extends through 2013 many popular individual relief provisions which expired at the end of 2011.

- above-the-line deduction for books, non-athletic supplies, computer equipment (including software and services and other equipment) and supplementary materials for elementary and secondary school teachers under IRC Section 62(a)(2)(D) (2012 Act Section 201)
- exclusion from gross income of discharge of qualified personal residence indebtedness under IRC Section 108(a)(1)(E) (2012 Act Section 202)
- exclusion from gross income for employer provided mass transit and parking benefits under IRC Section 132 (2012 Act Section 203)

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- extension of treatment of mortgage insurance premiums as qualified personal residence interest under IRC Section 163(h)(3)(E)(iv) (2012 Act Section 204)
- deduction of state and local general sales taxes under IRC Section 164(b)(5) (2012 Act Section 205)
- allowance of charitable deductions for real property used in agriculture or livestock production against 100% of the donor's charitable contribution base by individuals and corporations under IRC Section 170(b)(1)(E) (2012 Act Section 206)
- deduction from gross income for qualified tuition or related expenses under IRC Section 222 (2012 Act Section 207)
- deduction from gross income of up to $100,000 in distributions from individual retirement accounts given to qualifying charitable organizations by beneficiaries over age 70 ½ under IRC Section 408(d)(8) (2012 Act Section 208)

Effective Date: Generally effective for Taxable years after December 31, 2011.

Code Sections Affected: as specified above.

Sunset Date: December 31, 2013.

<u>Title III: Business Tax Extenders</u>

Similarly, the 2012 Act also extends through 2013 several popular business tax relief provisions which expired at the end of 2011.

- tax credit for qualified research expenses under IRC Section 41(h)(1) (2012 Act Section 301)
- low income tax credit for non-federally subsidized new buildings under IRC Section 42(b)(2) (2012 Act Section 302)
- housing allowance exclusion for determining area median gross income for qualified residential rental project exempt facility bonds under IRC Section 3005(b)
- Indian employment tax credit under IRC Section 45(A) (2012 Act Section 304)
- new market tax credit under IRC Section 45(D)(f)(1) (2012 Act Section 305)
- employer wage credit for active duty uniformed services personnel under IRC Section 45(P) (2012 Act Section 308)
- work opportunity tax credit under IRC Section 51(c)(4) (2012 Act Section 309)
- fifteen-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements ("Qualified Real Property") under IRC Section 168(e)(3)(e) (2012 Act Section 311)
- enhanced charitable deduction for contributions of food inventory under IRC Section 170(e)(3)(c) (2012 Act Section 314)
- election to expense up to $500,000 of acquisition costs of depreciable business assets (subject to reduction for expenditures in excess of $2,000,000) under IRC Section 179 (2012 Act Section 315)
- expensing for off-the-shelf computer software under IRC Section 179(d)(1)(a)(ii)

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- expensing for up to $250,000 of Qualified Real Property acquisition costs under IRC Section 179(f) (2012 Act Section 315)
- special expensing for certain film and television production costs under IRC Section 181 (2012 Act Section 317)
- exclusion from subpart F for active financing income of controlled foreign corporations under IRC Section 953(e) (2012 Act Section 322)
- look-through treatment for payments between related controlled foreign corporations under foreign personal holding rules of IRC Section 954(c)(6) (2012 Act Section 323)
- exclusion of 100% of gain recognized on sale of qualified small business stock under IRC Section 1202(a) (2012 Act Section 324)
- basis adjustment to stock of S-corporation making charitable contributions of property under IRC Section 1367(a) (2012 Act Section 325)
- reduction of the period for recognition of built-in gains by C-corporations converting to S-corporation status from 10 to 5 years under IRC Section 1374(d)
- empowerment zone tax incentives under IRC Section 1391(d)(1)(a) (2012 Act Section 327)
- 50% bonus depreciation for property depreciable under modified accelerated cost recovery system with recovery periods of 20 years or less under IRC Section 168(k) with extension of the placed-in service requirement from before January 1, 2014 to before January 1, 2015 for certain longer production period property and certain transportation property (2012 Act Section 331)

Effective Date: Generally effective for taxable years after December 31, 2011.

Code Sections Affected: As noted above.

Sunset Date: December 31, 2013.

Planning Note: *Choice of entity considerations*. Extension of the 100% exclusion of gain on sale of qualified small business stock combined with higher individual income tax rates merits reconsideration of C corporations as viable and tax efficient entities for privately-held businesses. As a result of the 2012 Act, stock of a qualified small business (as defined in IRC Section 1202(d)) (aggregate gross assets of $50 million or less) may be sold without gain recognition. In order to qualify 100% exclusion, the stock must have been acquired after September 27, 2010 and before January 1, 2013. The zero tax rate applies for both regular and alternative minimum tax purposes.

Title IV: Energy Tax Extenders

The 2012 Act extends twelve tax incentives set forth in energy related IRC provisions and amends IRC Section 30D by providing a tax credit for two- and three-wheeled plugin electric vehicles equal to 10% of the cost of the vehicle not to exceed $2,500. Many of the provisions extended had expired at the end of 2011. The 2012 Act amends IRC Section 45 to expand the definition of facilities qualifying for renewable energy; amends IRC Section 40(b)(6) to treat algae as

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qualified feed stock for purposes of the geologic biofuel producer credit; and amends IRC Section 168(l)(2) to allow bonus depreciation for property used to produce algae.

The 2012 Act extends the Energy Efficient Appliance Credit provided by IRC Section 45M. A tax credit is available to manufacturers of energy efficient appliances produced in the United States. In order to be eligible, the eligible appliances must exceed the manufacturer's average amount of US production from the two prior calendar years for each category of appliance. The 2012 Act adjusts the aggregate credit amount allowed with respect to a manufacturer for all taxable years beginning after December 31, 2007 from $75 million for that period to $25 million for appliances manufactured in 2011, 2012, or 2013. Additionally, the credit is 4% of average annual gross receipts for the three taxable years preceding the year in which the credit is determined.

In contrast to manufacturers of energy efficient appliances, consumers purchasing such appliances will no longer benefit from any tax incentive. The 2012 Act did not extend tax credits for non-business energy property available under the provisions of IRC Section 25c which expired on December 31, 2013.

Availability of production tax credits for renewable energy facilities is accelerated by the 2012 Act. Under prior law production tax credits were only available for wind, closed and open loop biomass, geothermal, solar efficient, small irrigation power facilities, landfill gas, municipal solid waste, refined coal production, qualified hydropower, Indian coal production, and marine hydrokinetic energy facilities if the facilities were placed in service before January 1, 2014. The 2012 Act changes the provisos of IRC Section 45(d) to make production tax credits available for construction which begins prior to January 1, 2014. The 2012 Act provides no date by which the construction must be complete or the facility placed in service.

Other energy-related IRC provisions addressed by the 2012 Act include:

- credit for energy efficient existing homes under IRC Section 25C (2012 Act Section 401)
- credit for alternative fuel vehicle refueling property under IRC Section 30C (2012 Act Section 402)
- credit for two- or three-wheeled plugin electric vehicles by amendment to IRC Section 30D (2012 Act Section 403)
- credit for qualified cellulosic biofuel production under IRC Section 40(b)(6)(2012 Act Section)
- credit for biodiesel and renewable diesel used at fuel under IRC Section 40A (2012 Act Section 405)
- credit for energy efficient new homes under IRC Section 45L (2012 Act Section 408)
- alternative fuels excise tax credits under IRC Section 6426 (2012 Act Section 412)

Effective Dates: Generally effective for taxable years after December 31, 2011.

Code Sections Affected: As noted above.

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Sunset Date: Generally for expenditures after December 31, 2012.

Title V: Budget Provisions

The 2012 Act permanently amends IRC Section 402A(c)(4) to allow tax qualified retirement plans which include qualified ROTH contribution programs to permit plan participants to transfer account balances to designated ROTH accounts maintained for the benefit of the participant. Under prior law such transfers would only be available on separation from service or, in the case of in-plan conversions, when the plan participant reached age 59 1/2. The opportunity to do in-plan ROTH conversions is still limited to participants in tax qualified retirement plans which have been drafted or amended to provide ROTH conversion features.

Non-Tax Provisions

The 2012 Act includes several politically and economically significant non-tax provisions, including

- extension of emergency unemployment compensations benefits provided by the Supplemental Appropriations Act of 2008 (Pub. L. No. 110-252) through December 31, 2013 (2012 Act Section 501)
- extension of the Assistance for Unemployed Workers and Struggling Families Act (Pub. L. No. 111-5) through December 31, 2013 (2012 Act Section 502)
- extension funding for reemployment services and reemployment and eligibility assessment activities under the Supplemental Appropriations Act of 2008 through fiscal year 2014 (2012 Act Section 503)
- a variety of Medicare extensions including deferral of factors adversely affecting physician payments (2012 Act Section 601)
- a one-year extension of agricultural subsidies provided by the Food, Conservation, and Energy Act of 2008 (through at least September 30, 2013) (2012 Act Section 701)
- elimination of cost of living adjustments for compensation paid to members of Congress during fiscal year 2013 (2012 Act Section 902)
- postponement of budget control act sequestration until March 1, 2013 under the provisions of the Balanced Budget and Emergency Deficit Control Act of 1985 (2012 Act Section 1001)
- modifications in the amounts of discretionary spending limitations for fiscal years 2013 and 2014 (2012 Act Section 1001).

Tax Provisions Which Were Not Extended

Despite the extension of many individual, business, and energy tax incentives, the 2012 Act failed to extend several tax initiatives enacted by recent tax acts including

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- payroll tax reductions originally enacted as part of the Hiring Incentives to Restore Employment ("HIRE") Act (Pub. L. No. 111-147) and modified and extended by the 2009 Act and subsequent tax legislation
- charitable deductions for gifts of corporate computer technology property for education under IRC Section 170(e)(6)
- expensing of brownfield environmental remediation costs
- enhanced charitable deduction provided by IRC Section 170(e)(3)(C) for contributions of food inventory
- enhanced charitable deduction provided by IRC Section 170(e)(3)(D) for contributions of book inventories to public schools
- exclusion provided by IRC Section 897(h)(4)(A) of regulated investment companies from the definition of a US real property interests for purposes of the Foreign Investment and Real Property Tax Act of 1980
- look-through rule of IRC Section 954(c)(6) which allows dividends, interest, rents, and royalties paid to a controlled foreign corporation from a related controlled foreign corporation to be excluded from the definition of foreign personal holding company income (and thereby subpart F income)
- basis adjustment to stock of an S corporation making charitable contributions of property provided by IRC Section 1367(a)

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