

A Closer Look

Tax Extender Legislation — A Positive Step on the PATH to Tax Reform?



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In Brief

- Recent legislative changes have made permanent certain provisions in the tax code that previously were extended by Congress each year before the annual holiday break.
- In this *A Closer Look*, Stephen Baxley discusses key provisions of the PATH Act. In particular, he focuses on the permanent changes that will affect higher-income taxpayers and how this radical shift in the treatment of extender provisions may also have the effect of removing a major speed bump on the road to comprehensive tax reform.

On December 18, 2015, President Obama signed into law the Protecting Americans from Tax Hikes Act of 2015 (PATH Act). The \$1.8 trillion act is notable in that it made permanent many (but not all) of the short-term tax provisions historically extended by Congress each year before the annual holiday break.

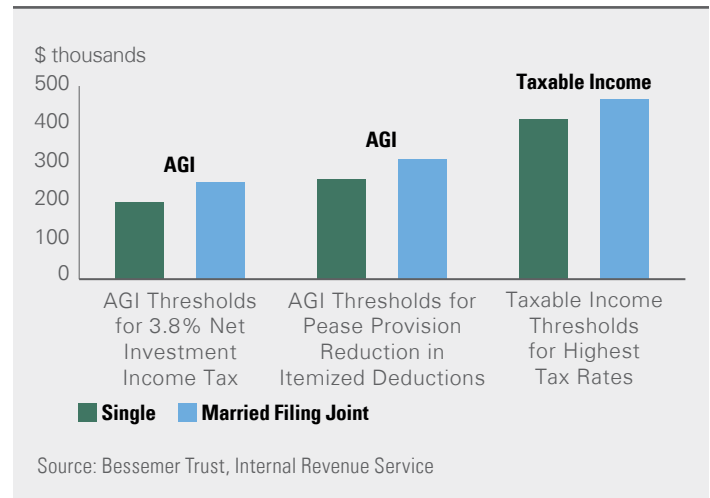
Qualified Charitable Distributions

A qualified charitable distribution (QCD) is an otherwise taxable distribution from a qualified IRA that is paid directly to a charitable nonprofit. While Congress had temporarily extended the use of the QCD in past years, in December 2015, legislation made the QCD tax exemption permanent with retroactive application to January 1, 2015.

This popular provision allows individuals aged 70.5 years or older to make charitable contributions of up to \$100,000 directly from their IRAs to qualified public charities. The amount distributed is fully excluded from income, which is the equivalent of a full charitable deduction. Importantly, the reduction in reportable adjusted gross income (AGI) and taxable income can produce an additional tax benefit.

A taxpayer will typically be subject to greater net investment income tax, reduced itemized deductions, and higher tax rates as AGI and taxable income levels move beyond key thresholds (Exhibit 1).

Exhibit 1: Key AGI Threshold Levels



QCD Reminders:

- Charitable recipients must be public charities; donor-advised funds (DAFs) and private foundations will not qualify;
- QCDs can fulfill previously existing pledges;
- The donor may not receive any benefit from the charity in connection with the contribution; and
- IRA minimum distribution requirements can be satisfied with QCDs.

Qualified Small Business Stock (QSBS)

For business owners, the qualified small business stock (QSBS) exclusion treatment is now permanent. Under this provision, some or all of the gain on the sale of QSBS held more than five years will be excluded from income and will no longer be treated as a preference item in the calculation of alternative minimum tax (AMT).

To claim a QSBS-related exemption, the following conditions must be met:

- Stock must be in a domestic C corporation, not an S corporation or LLC;
- The corporation may not have more than \$50 million in assets as of the date the stock was issued;
- The stock must be acquired at its original issue;
- At least 80% of the corporation's assets must be used in the active conduct of one or more qualified businesses, which excludes a wide swath of enterprises such as professional services, banking, financing, leasing, and consulting, among others; and
- An excludable gain is limited to the greater of \$10 million or ten times the investor's basis in the stock.

Deduction of State and Local Sales Taxes

Deduction of state and local sales taxes is a permanent option for residents of low- or no-income tax states. Taxpayers may claim an itemized deduction for state and local income or sales taxes, but not both.

Qualified Conservation Charitable Contribution

Qualified conservation charitable contribution tax breaks have now also been made permanent by the PATH Act. These donations of real property interests, such as remainder interests and easements that restrict the use of property, may qualify for liberalized maximum write-offs. The allowable annual deduction has been raised from 30% of AGI with a five-year carryforward to 50% of AGI with a 15-year carryforward. Qualified farmers and ranchers can deduct up to 100% of AGI.

Solar and Wind Energy Tax Credits

Solar and wind energy tax credits were not made permanent, but were extended five years through 2021. Qualified investments continue to be eligible for an increased credit calculated at up to 30% of cost, depending on when the property is placed in service.

PATH Act Potential Effects on Tax Reform

In a convoluted fashion, the PATH Act could help pave the way to comprehensive tax reform. It is all a matter of the budget baselines used to score various legislative proposals. If the extender provisions had been allowed to expire as scheduled, the congressional budget baseline would be \$600 billion higher. Consequently, tax-reform legislation would need to generate this additional revenue, making the prospect of lower tax rates more challenging. The recent permanency of expiring provisions makes it easier for legislators to draft tax reform that includes lower income tax rates.

In a final twist of Beltway irony, we should not be surprised if many of these recently permanent extender provisions are only temporarily permanent. They may be on the chopping block when tax writers in Washington look for ways to pay for lower income tax rates.

We hope you find this information to be helpful. If you have any questions or would like to discuss further, please contact your Client Advisor or one of our Senior Tax Consultants.

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