Business Tax Breaks Retroactively Reinstated and Extended by the 2012 Taxpayer Relief Act-Jan.11, 2013

On Jan. 1, 2013, Congress passed the American Taxpayer Relief Act of 2012 (2012 Taxpayer Relief Act), which the President quickly signed into law on Jan. 2, 2013. The 2012 Taxpayer Relief Act will prevent many of the tax hikes that were scheduled to go into effect this year and retain many favorable tax breaks that were scheduled to expire, but will also increase income taxes for some high-income individuals and slightly increase transfer tax rates from 2012 levels. Further, it extends a host of expired and expiring tax breaks for businesses and individuals.

This Special Study explains how the 2012 Taxpayer Relief Act retroactively reinstates and extends for two years a host of business tax breaks, including: the research credit; generous Code Sec. 179 expensing and phaseout limits; the new markets tax credit; employer wage credit for activated reservists; 15-year writeoff for qualifying leasehold improvements, restaurant buildings and improvements, and retail improvements; enhanced charitable deductions for contributions of food inventory; and empowerment zone tax incentives. It also covers the Act's one-year extension of 50% bonus first-year depreciation.

Research Credit Reinstated and Liberalized

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.

Under pre-2012 Taxpayer Relief Act law (pre-Act law), the research credit didn't apply for amounts paid or accrued after Dec. 31, 2011.

New law. The 2012 Taxpayer Relief Act retroactively extends the research credit (including the university basic research credit and the energy research consortium credit) for two years so that it applies for amounts paid or accrued before Jan. 1, 2014. (Code Sec. 41(h)(1), as amended by Act Sec. 301(a))

For tax years beginning after Dec. 31, 2011, the 2012 Taxpayer Relief Act liberalizes the research credit rules for persons that acquire the major portion of either a trade or business or a separate unit of a trade or business of another person. Here, for purposes of calculating the allowable research credit, the amount of qualified research expenses paid or incurred by the acquiring person during the measurement period is increased by certain expenses of the predecessor, and the gross receipts of the acquiring person for such period is increased by certain gross receipts of the predecessor. The measurement period is, with respect to the tax year of the acquiring person for which the research credit is determined, any period of the acquiring person preceding such tax year which is taken into account for purposes of determining the credit for such year. (Code Sec. 41(f)(3)(A) and Code Sec. 41(f)(3)(B), as amended by Act Sec. 301(b))

The 2012 Taxpayer Relief Act also revises the rules for allocating the research credit among members of a controlled group or members of a group of commonly controlled trades or businesses. For tax years beginning after Dec. 31, 2011, the credit for each member of a controlled group is determined on a proportionate basis to its share of the aggregate of the qualified research expenses, basic research payments, and amounts paid or incurred to energy research consortiums, taken into account by such controlled group for purposes of the research credit. (Code Sec. 41(f)(1)(A)(ii), as amended by Act Sec. 301(c)) A similar rule applies to members of a group of commonly controlled trades or businesses. (Code Sec. 41(f)(1)(B)(ii), as amended by Act Sec. 301(c))

Recommendation: Because the extension of the research credit is retroactive to include amounts paid or incurred after Dec. 31, 2011, taxpayers, such as fiscal year corporations that already filed returns for a fiscal year that includes part of 2012, or any other taxpayers that have filed returns for tax years ending after Dec. 31, 2011, should consider filing an amended return to claim a refund for the amount of any additional tax paid because of not claiming amounts now eligible for the credit.

Bonus First-Year Depreciation Extended for One Year

Under pre-Act law, the Code Sec. 168(k) additional first-year depreciation deduction (also called bonus first-year depreciation) generally is allowed equal to 50% of the adjusted basis of qualified property acquired and placed in service after Dec. 31, 2011, and before Jan. 1, 2013 (before Jan. 1, 2014 for certain longer-lived and transportation property). The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax (AMT) purposes, but is not allowed for purposes of computing earnings and profits. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. A taxpayer may elect out of additional first-year depreciation for any class of property for any tax year.

In general, an asset qualifies for the bonus depreciation allowance if:

- It falls into one of the following categories: property to which the modified accelerated cost recovery system (MACRS) rules apply with a recovery period of 20 years or less; computer software other than computer software covered by Code Sec. 197; qualified leasehold improvement property; or certain water utility property.

- It is placed in service before Jan. 1, 2013. (Certain long-production-period property and certain transportation property may be placed in service before Jan. 1, 2014)
- Its original use commences with the taxpayer. Original use is the first use to which the property is put, whether or not that use corresponds to the taxpayer's use of the property.

Under pre-Act law, these bonus depreciation provisions didn't apply to property placed in service after Dec. 31, 2012 (Dec. 31, 2013 for certain longer-lived and transportation property).

New law. The 2012 Taxpayer Relief Act extends 50% first-year bonus depreciation so that it applies to qualified property acquired and placed in service before Jan. 1, 2014 (before Jan. 1, 2015 for certain longer-lived and transportation property). (Code Sec. 168(k)(2), as amended by Act Sec. 331(a)) A conforming change is made to Code Sec. 460(c)(6)(B) (relating to 50% bonus depreciation not being taken into account as a cost in applying the percentage of completion method for certain long-term contracts).

Observation: The 2012 Taxpayer Relief Act also retroactively revives and extends through 2013 the Code Sec. 168(e)(3)(E)(iv) rule treating qualified leasehold improvement property as 15-year property. See discussion below. Thus, such property is eligible for a bonus 50% first-year depreciation deduction if placed in service before Jan. 1, 2014.

Observation: The 2012 Taxpayer Relief Act also extends through 2013 the Code Sec. 168(e)(3)(E)(v) rule treating qualified restaurant property as 15-year property and the Code Sec. 168(e)(3)(E)(ix) rule treating qualified retail improvement property as 15-year property. See discussion below. These types of property also are eligible for 50% bonus first-year depreciation under Code Sec. 168(k) if they also meet the definition of qualified leasehold improvement property. (See Weekly Alert ¶ 3 01/26/2012 and Weekly Alert ¶ 1 02/24/2011 for details.)

First-Year Depreciation Cap for 2013 Autos and Trucks Boosted by $8,000

Under the luxury auto dollar limits of Code Sec. 280F, depreciation deductions (including Code Sec. 179 expensing) that can be claimed for passenger autos are subject to dollar limits that are annually adjusted for inflation. For passenger automobiles placed in service in 2012, the adjusted first-year limit is $3,160. For light trucks or vans, the adjusted first-year limit is $3,360. Light trucks or vans are passenger automobiles built on a truck chassis, including minivans and sport-utility vehicles (SUVs) built on a truck chassis that are subject to the Code Sec. 280F limits because they are rated at 6,000 points gross (loaded) vehicle weight or less.

The applicable first-year depreciation limit is increased by $8,000 (not indexed for inflation) for any passenger automobile that is “qualified property” under the bonus depreciation rules of Code Sec. 168(k) and which isn't subject to a taxpayer election to decline bonus depreciation.

Under pre-Act law, qualified property didn't include property placed in service after Dec. 31, 2012 (except for certain aircraft and certain long-production-period property that had, instead, a Dec. 31, 2013 placed-in-service deadline). Thus, under pre-Act law, the $8,000 boost in first-year depreciation allowances wasn't available for new cars and trucks purchased after 2012.

New law. The 2012 Taxpayer Relief Act provides that the placed-in-service deadline for “qualified property” is Dec. 31, 2013 (Dec. 31, 2014 for aircraft and long-production-period property). (Code Sec. 168(k)(2), as amended by Act Sec. 331(a))

Observation: Thus, for a passenger auto that is qualified property under Code Sec. 168(k), (and isn't subject to the election to decline bonus depreciation and AMT depreciation relief), the 2012 Taxpayer Relief Act extends the placed-in-service deadline for the $8,000 increase in the first-year depreciation limit from Dec, 31, 2012 to Dec. 31, 2013.

Illustration : T, a calendar year taxpayer, places a new $40,000 vehicle into service in his business on Jan. 5, 2013. Assume that: (1) the vehicle is an auto that is “qualified property” (and an election to decline bonus depreciation and AMT depreciation relief doesn't apply to the vehicle); and (2) the passenger auto first-year allowances remain unchanged for 2013. T is allowed first-year depreciation for 2013 of $11,160 ($3,160 presumed general first-year allowance for 2013 plus $8,000). If the vehicle were instead a light truck or van, T is allowed first-year depreciation for 2013 of $11,360 (the presumed $3,360 general first-year allowance for 2013 plus $8,000).

Extended Choice to Forego Bonus Depreciation and Claim Credits Instead

Pre-Act law's Code Sec. 168(k)(4) generally permits a corporation to increase the AMT credit limitation (but not the research credit limitation) by the bonus depreciation amount with respect to certain property placed in service after Dec. 31, 2010 and before Jan. 1, 2013 (Jan. 1, 2014 in the case of certain longer-lived and transportation property).

Under pre-Act law, the above provision didn't apply to such property placed in service after Dec. 31, 2012 (Dec. 31, 2013 in the case of certain longer-lived and transportation property).

New law. For property placed in service after Dec. 31, 2012, in tax years ending after that date, the 2012 Taxpayer Relief Act provides a similar option to corporations with respect to “round three extension property,” generally, property newly eligible for 50% bonus first-year depreciation under the 2012 Taxpayer Relief Act's one-year extension provision, i.e., property placed in service after 2012 and before 2014 (before 2015 for the aircraft and long-production-period property). (Code Sec. 168(k)(4)(d) and Code Sec. 168(k)(4)(J) , as amended by Act Sec. 331(c))

Boosted Expensing Amounts for 2013

Under Code Sec. 179, a taxpayer, other than an estate, a trust, or certain noncorporate lessors, can elect to deduct as an expense, rather than to depreciate, up to a specified amount of the cost of new or used tangible personal property placed in service during the tax year in the taxpayer's trade or business. The maximum annual expensing amount generally is reduced dollar-for-dollar by the amount of Code Sec. 179 property placed in service during the tax year in excess of a specified investment ceiling. Amounts ineligible for expensing due to excess investments in expensing-eligible property can't be carried forward and expensed in a subsequent year. Rather, they can only be recovered through depreciation. The amount eligible to be expensed for a tax year can't exceed the taxable income derived from the taxpayer's active conduct of a trade or business. And any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding tax years.

Under pre-Act law, the maximum amount that may be expensed for tax years beginning in 2011 is $500,000. For tax years beginning in 2012, the maximum amount is $139,000. For tax years beginning after 2012, the maximum amount is $25,000. For tax years beginning in 2011, the maximum annual expensing amount generally is reduced dollar-for-dollar by the amount of section 179 property placed in service during the tax year in excess of $2,000,000 (the investment ceiling). For tax years beginning in 2012, the investment ceiling is $560,000. For tax years beginning after 2012, the investment ceiling is $200,000.

In general, under pre-Act law, property is eligible for Code Sec. 179 expensing if it is:

- tangible property that's Code Sec. 1245 property (generally, machinery and equipment), depreciated under the MACRS rules of Code Sec. 168, regardless of its depreciation recovery period;
- for any tax year beginning in 2010 or 2011, up to $250,000 of qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property); and
- off-the-shelf computer software, but only if placed in service in a tax year beginning before 2013. (Code Sec. 179(d)(1))

Under pre-Act law, for tax years beginning before 2013, an expensing election or specification of property to be expensed may be revoked without IRS's consent, but, if revoked, can't be re-elected.

New law. Retroactively effective for tax years beginning in 2012, the 2012 Taxpayer Relief Act increases the maximum expensing amount under Code Sec. 179 from $139,000 to $500,000. Effective for tax years beginning in 2013, the 2012 Taxpayer Relief Act increases the maximum expensing amount under Code Sec. 179 from $25,000 to $500,000. The 2012 Taxpayer Relief Act also increases the investment-based phaseout amount for tax years beginning in 2012 or 2013 to $2,000,000. However, for tax years beginning after 2013, the maximum expensing amount is scheduled to drop to $25,000 and the investment-based phaseout amount is scheduled to drop to $200,000. (Code Sec. 179(b), as amended by Act Sec. 315(a))

Observation: The retroactive boost for tax years beginning in 2012 amounts to a windfall for eligible taxpayers that placed in service more than $139,000 of eligible property.

The Act also provides that:

- Off-the-shelf computer software is expensing-eligible property if placed in service in a tax year beginning before 2014 (a one-year extension). (Code Sec. 179(d)(1)(A)(ii)
- For tax years beginning before 2014 (also a one-year extension), an expensing election or specification of property to be expensed may be revoked without IRS's consent. But, if such an election is revoked, it can't be reelected. (Code Sec. 179(c)(2))
- For any tax year beginning in 2010, 2011, 2012, or 2013 (a two-year extension), up to $250,000 of qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property) is eligible for expensing under Code Sec. 179. (Code Sec. 179(f)(1))

15-Year Writeoff for Qualified Leasehold and Retail Improvements and Restaurant Property Reinstated and Extended

Qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property that was placed in service before 2012 was included in the 15-year MACRS class for depreciation purposes—that is, such property was depreciated over 15 years under MACRS.

Under pre-Act law, the above rules didn't apply to property placed in service after Dec. 31, 2011.

New law. The 2012 Taxpayer Relief Act retroactively extends for two years the inclusion of qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property in the 15-year MACRS class. Such property qualifies for 15-year recovery if it is placed in service before Jan. 1, 2014. (Code Sec. 168(e)(3)(E), and Code Sec. 168(e)(8)(E), as amended by Act Sec. 311)

7-Year Writeoff for Motorsport Racing Track Facilities Reinstated and Extended

A short 7-year cost recovery period applies to property used for land improvement and support facilities at motorsports entertainment complexes.

Under pre-Act law, the short writeoff period only applies for property placed in service on or before Dec. 31, 2011.

New law. The 2012 Taxpayer Relief Act retroactively extends the 7-year straight line cost recovery period for motorsports entertainment complexes for two years. The quick writeoff applies to qualifying motorsports entertainment complexes placed in service through Dec. 31, 2013. (Code Sec. 168(i)(15)(D), as amended by Act Sec. 738)

Work Opportunity Tax Credit Extended

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: (1) a non-veteran who began work after Dec. 31, 2011; or (2) a veteran who began work after Dec. 31, 2012.

New law. The 2012 Taxpayer Relief Act retroactively extends the WOTC so that it applies to eligible veterans **and** nonveterans who begin work for the employer before Jan. 1, 2014. (Code Sec. 51(c)(4)(B), as amended by Act Sec. 309)

Observation: Thus, the 2012 Taxpayer Relief Act grants a two-year lease on life for the WOTC for eligible nonveterans, and a one-year lease on life for the WOTC for qualifying veterans.

Indian Employment Credit Reinstated and Extended

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, 2011.

New law. The 2012 Taxpayer Relief Act retroactively extends the Indian employment credit for two years. It now applies to tax years beginning before Jan. 1, 2014. (Code Sec. 45A(f), as amended by Act Sec. 304)

Differential Wage Payment Credit for Employers Reinstated and Extended

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 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, 2011.

New law. The 2012 Taxpayer Relief Act retroactively extends the credit for two years. It applies for differential wages paid through Dec. 31, 2013. (Code Sec. 45P(f), as amended by Act Sec. 736)

Enhanced Deduction for Food Inventory Reinstated and Extended

A C corporation may claim an enhanced charitable contribution deduction equal to 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. The enhanced contribution is also available for a taxpayer other than a C corporation, but 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, 2011.

New law. The 2012 Taxpayer Relief Act retroactively extends the apparently wholesome food contribution rules for two years to include contributions made before Jan. 1, 2014. (Code Sec. 170(e)(3)(C)(iv), as amended by Act Sec. 314)

Observation: The 2012 Taxpayer Relief Act did **not** extend the enhanced deduction for charitable contributions of books (this deduction ceased to apply for contributions made after Dec. 31, 2011), or the enhanced deduction for corporate contributions of computer equipment for educational purposes (this deduction ceased to apply for contributions made during any tax year beginning after Dec. 31, 2011).

New Markets Tax Credit Reinstated and Extended

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 and 2011; 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 2016.

New law. The 2012 Taxpayer Relief Act retroactively extends the new markets tax credit two years, through 2013. It provides that a $3.5 billion cap applies for 2010, 2011, 2012, and 2013, but no amount can be carried over to any calendar year after 2018. (Code Sec. 45D(f), as amended by Act Sec. 305)

Expensing Election for Costs of Film and TV Production Extended

Taxpayers may elect to expense production costs of qualified film and television (TV) productions in the U.S. Expensing doesn't apply to the part of the cost of any qualifying film or TV production that exceeded $15 million for each qualifying production. The limit is $20 million if production expenses were “significantly incurred” in areas (1) eligible for designation as a low-income community or (2) eligible for designation by the Delta Regional Authority (a federal-state partnership covering parts of certain states) as a low-income community or isolated area of distress.

Under pre-Act law, these rules didn't apply to qualified film and TV productions beginning after Dec. 31, 2011.

New law. The 2012 Taxpayer Relief Act retroactively extends the expensing provision for two years. It applies for qualified film and TV productions beginning before Jan. 1, 2014. (Code Sec. 181(f), as modified by Act Sec. 317)

Allowance of Domestic Production Activities Deduction for Puerto Rico Reinstated and Extended

The Code Sec. 199 domestic production activities deduction is available only if, among other conditions, the taxpayer has domestic production gross receipts (DPGR) from: (1) any sale, exchange or other disposition, or any lease, rental or license, of qualifying production property manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the U.S.; (2) any sale, exchange, etc., of qualified films produced by the taxpayer; (3) any sale, exchange or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the U.S.; (4) construction activities performed in the U.S.; or (5) engineering or architectural services performed in the U.S. for construction projects located in the U.S.

Under pre-Act law, for the first six tax years of a taxpayer beginning after Dec. 31, 2005 and before Jan. 1, 2012, Puerto Rico was included in the term “U.S.” in determining DPGR, but only if all of the taxpayer's Puerto Rico-sourced gross receipts were taxable under the federal income tax for individuals or corporations.

New law. The 2012 Taxpayer Relief Act retroactively extends the special domestic production activities rules for Puerto Rico for two years through 2013. Under the Act, the special domestic production activities rules for Puerto Rico apply for the first eight tax years of a taxpayer beginning after Dec. 31, 2005 and before Jan. 1, 2014. (Code Sec. 199(d)(8)(C), as amended by Act Sec. 318)

Subpart F Exception for Active Financing Income Reinstated and Extended

Certain income from the active conduct of a banking, financing or similar business, or from the conduct of an insurance business (collectively referred to as “active financing income”), was temporarily excluded from the definition of Subpart F income, but only for tax years of foreign corporations beginning after Dec. 31, '98 and before Jan. 1, 2012, and tax years of U.S. shareholders with or within which such tax years of foreign corporations end.

Under pre-Act law, this exception didn't apply to tax years beginning after Dec. 31, 2011.

New law. The 2012 Taxpayer Relief Act retroactively extends the exclusions for active financing income for two years. Thus, this rule applies to tax years of a foreign corporation beginning after Dec. 31, '98 and before Jan. 1, 2014, and tax years of U.S. shareholders with or within which such tax years of foreign corporations end. (Code Sec. 953(e)(10) and Code Sec. 954(h)(9), as amended by Act Sec. 322)

Look-Through Rule for Payments Between Related CFCs under Foreign Personal Holding Company Income Rules Reinstated and Extended

For tax years beginning before Jan. 1, 2012, dividends, interest, rents, and royalties received by one controlled foreign corporation (CFC) from a related CFC were not treated as foreign personal holding company income (FPHCI) to the extent attributable or properly allocable to non-subpart-F income, or income that was not effectively connected with the conduct of a U.S. trade or business of the payor (look-through treatment).

Under pre-Act law, this provision didn't apply to tax years beginning after Dec. 31, 2011.

New law. The 2012 Taxpayer Relief Act retroactively extends look-through treatment for related CFCs for two years. Thus, the above rule applies to tax years of a foreign corporation before Jan. 1, 2014, and tax years of U.S. shareholders with or within which such tax years of foreign corporations end. (Code Sec. 954(c)(6)(C), as amended by Act Sec. 323)

Reduction in S Corp Recognition Period for Built-In Gains Tax Modified and 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 elected 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 2011, no tax is imposed on the net unrecognized built-in gain of an S corporation if the fifth year in the recognition period preceded the 2011 tax year.

New law. The 2012 Taxpayer Relief Act provides that for determining the net recognized built-in gain for tax years beginning in 2012 or 2013, the recognition period is the 5-year period beginning with the first day of the first tax year for which the corporation was an S corporation. (Code Sec. 1374(d)(7)(C), as amended by Act Sec. 326(a)(2))

Additionally, effective for tax years beginning after Dec. 31, 2011, for S corporations that report gain from the sale of an asset under the installment method (Code Sec. 453), the treatment of all payments received is governed by the provisions of Code Sec. 1374(d)(7) that apply to the tax year in which the sale was made. (Code Sec. 1374(d)(7)(E), as amended by Act Sec. 326(a)(3))

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

A taxpayer may exclude all of the gain on the disposition of qualified small business stock acquired after Sep. 27, 2010 and before Jan. 1, 2012.

Under pre-Act law, the exclusion was to be limited to 50% of gain for stock acquired after Dec. 31, 2011.

New law. The 2012 Taxpayer Relief Act retroactively extends this provision for two years so that taxpayers may exclude 100% of gain from the disposition of qualified small business stock acquired after Sep. 27, 2010 and before Jan. 1, 2014. (Code Sec. 1202(a)(4), as amended by Act Sec. 324(a)) The 2012 Taxpayer Relief Act also makes certain technical amendments relevant to qualified small business stock acquired during earlier periods (Code Sec. 1202(a)(3) and Code Sec. 1202(a)(4) , as amended by Act Sec. 324(b))

Lower Shareholder Basis Adjustments for Charitable Contributions by S Corporations Reinstated and 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, 2011.

New law. The 2012 Taxpayer Relief Act retroactively extends the PPA rule for two years so that it applies for contributions made in tax years beginning before Jan. 1, 2014. (Code Sec. 1367(a)(2), as amended by Act Sec. 325)

Special Rule for Payments to a Charity From a Controlled Entity Reinstated and Extended

For 2006–2011, interest, rent, royalties, and annuities paid to a tax-exempt organization from a controlled entity were excluded from the unrelated business taxable income (UBTI) of the tax exempt organization.

Under pre-Act law, this exclusion didn't apply to payments received or accrued after Dec. 31, 2011, and such payments were to be treated as UBTI to the extent that the payments reduce the “net unrelated income” of the controlled entity.

New law. The 2012 Taxpayer Relief Act retroactively extends the special rule for two years so that it applies for payments received or accrued by a tax-exempt organization through Dec. 31, 2013. (Code Sec. 512(b)(13)(E)(iv), as amended by Act Sec. 319)

Empowerment Zone Tax Breaks Reinstated and Extended

The designation of an economically depressed census tract as an “Empowerment Zone” renders businesses and individual residents within such a Zone eligible for special tax incentives. Under pre-Act law, Empowerment Zone designations expired on Dec. 31, 2011.

New law. The 2012 Taxpayer Relief Act extends for two years, through Dec. 31, 2013, the period for which the designation of an empowerment zone is in effect. (Code Sec. 1391(d) , as amended by Act Sec. 327(a)) Thus, the Act extends for two years the empowerment zone tax incentives, including: the 20% wage credit under Code Sec. 1396; liberalized Code Sec. 179 expensing rules ($35,000 extra expensing and the break allowing only 50% of expensing eligible property to be counted for purposes of the investment-based phaseout of expensing); tax-exempt bond financing under Code Sec. 1394; and deferral under Code Sec. 1397B of capital gains tax on sale of qualified assets sold and replaced.

For a designation of an empowerment zone, the nomination for which included a termination date which is Dec. 31, 2011, termination shall not apply with respect to that designation if the entity which made such nomination amends the nomination to provide for a new termination date in such manner as IRS may provide. (Act Sec. 327(c))

The Act also extends for two years, through Dec. 31, 2018, the period for which a higher percentage exclusion applies for certain qualified small business stock of empowerment zone businesses. (Code Sec. 1202(a)(2), as amended by Act Sec. 327(b))

Qualified Zone Academy Bond Limitation Extended

Qualified zone academy bonds are qualified tax credit bonds designed to allow low-income populations to save on interest costs associated with public financing school renovations, repairs, and teacher training. For 2011, the national bond volume limitation on qualified zone academy bonds was $400 million.

Under pre-Act law, except for carryovers of unused issuance limitations, the limit for years after 2011 was zero.

New law. The 2012 Taxpayer Relief Act provides that the national bond volume limitation is $400 million for 2011, 2012, and 2013. (Code Sec. 54E(c)(1), as amended by Act Sec. 310)

Exemption for RIC Interest-Related Dividends and Short-Term Capital Gains Dividends Reinstated and Extended

Under pre-Act law, a regulated investment company (RIC) could designate and pay (1) interest-related dividends out of interest that would generally not be taxable when received directly by a nonresident alien individual or foreign corporations and (2) short-term capital gains dividends out of short-term capital gains. RIC dividends designated as interest-related dividends and short-term capital gains dividends were generally not taxable when received by a nonresident alien individual or foreign corporation and weren't subject to the withholding tax imposed on nonresident alien individuals and foreign corporations.

Under pre-Act law, these provisions didn't apply to dividends with respect to any tax year of a RIC beginning after Dec. 31, 2011.

New law. The 2012 Taxpayer Relief Act retroactively extends for two years the rules exempting from gross basis tax and withholding tax the interest-related dividends and short-term capital gain dividends received from a RIC, for dividends with respect to tax years of a RIC beginning before Jan. 1, 2014. (Code Sec. 871(k), as amended by Act Sec. 320)

Treatment of RIC As Qualified Investment Entity Reinstated and Extended

Gain from the disposition of a U.S. real property interest (USRPI) by a foreign person is treated as income effectively connected with a U.S. trade or business and is subject to tax and to Code Sec. 1445 withholding under Foreign Investment in Real Property Tax Act (FIRPTA) provisions. A USRPI does not include an interest in a domestically controlled “qualified investment entity.”

Under pre-Act law, before Jan. 1, 2012, a RIC that met certain requirements could be treated as a “qualified investment entity.”

New law. The 2012 Taxpayer Relief Act extends the inclusion of a RIC within the definition of a “qualified investment entity” for two years, through 2013. (Code Sec. 897(h)(4)(A), as amended by Act Sec. 321(a)) The change made by Act. Sec. 321(a) takes effect on Jan. 1, 2012, but the 2012 Tax payer Relief Act doesn't impose a withholding requirement under Code Sec. 1445 for any payment made before Jan. 2, 2013. A RIC that withheld and remitted tax under Code Sec. 1445 on distributions made after Dec. 31, 2011 and before Jan. 2, 2013, isn't liable to the distributee for such withheld and remitted amounts. (Act Sec. 321(b))

Miscellaneous Other Provisions Repealed, Modified, or Extended

The 2012 Taxpayer Relief Act:

- Permanently repeals the collapsible corporation rules (which have been repealed on a temporary basis since 2003) via the repeal of the JGTRRA sunset. (Former Code Sec. 341, as amended by Act Sec. 102(a))
- Extends and modifies the temporary minimum credit rate (9%) for the low-income housing tax credit program; it now applies to non-federally subsidized new buildings that have received an allocation before Jan. 1, 2014. (Code Sec. 42(b)(2), as amended by Act Sec. 302)
- Retroactively extends a provision under which the basic housing allowance of a military member is excluded from income for purposes of determining the individual qualification as a “low-income tenant” for purposes of the low-income housing tax credit program; it now applies for tax years beginning before Jan. 1, 2014. (Sec. 3005 of the Housing Assistance Tax Act of 2008, as amended by Act Sec. 303)
- Retroactively extends the railroad track maintenance credit for two years; it now applies for tax years beginning before Jan. 1, 2014. (Code Sec. 45G(f), as amended by Act Sec. 306)
- Retroactively extends the mine rescue team training credit for two years; it will terminate for tax years beginning after Dec. 31, 2013. (Code Sec. 45N(e), as amended by Act Sec. 307)
- Retroactively extends accelerated depreciation for qualified Indian reservation property for two years for property placed in service through 2013. (Code Sec. 168(j), as amended by Act Sec. 313)

- Retroactively extends the election to expense 50% of the cost of advanced mine safety equipment for two years, through 2013. (Code Sec. 179E(g), as amended by Act Sec. 316)
- Retroactively extends the increase in the limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands for two years, through 2013. (Code Sec. 7652(f), as amended by Act Sec. 329)
- Retroactively extends tax-exempt bond financing for the New York Liberty Zone for two years; such bonds can be issued before Jan. 1, 2014. (Code Sec. 1400L(d)(2), as amended by Act Sec. 328)
- Retroactively extends the possessions tax credit for American Samoa for two years (for tax years beginning before Jan. 1, 2014), and modifies it to eliminate the requirement that the corporation claiming the credit be an existing credit claimant for tax years beginning after Dec. 31, 2011, making it available to all qualifying manufacturing businesses operating there. (Sec. 119(a) of the Tax Relief and Health Care Act of 2006, as amended by Act Sec. 330)