Technical corrections bill would make important modifications to five tax laws

On December 2, Ways and Means Committee Chair Charles B. Rangel (D-NY) and Ranking Member Dave Camp (R-MI) introduced H.R. 4169, the "Tax Technical Corrections Act of 2009." This bill would make 25 changes to tax provisions in five recent tax laws: The American Recovery and Reinvestment Act of 2009 (ARRA, P.L. 111-5), the Emergency Economic Stabilization Act of 2008 (EESA, P.L. 110-343), the Heroes Earnings Assistance and Relief Tax Act of 2008 (Heroes Act, P.L. 110-245), the Economic Stimulus Act of 2008 (Stimulus Act, P.L. 110-185, and the Tax Technical Corrections Act of 2007 (P.L. 110-172) Changes would be effective as if included in the law that's being amended.

The technical corrections bill apparently will be on the fast track, with the Senate expected to introduce the identical bill. The bill may well go right to the House and Senate, bypassing the committee process.

Following are highlights of five of the more widely applicable changes in the tax technical corrections bill.

Education credits. Before ARRA, for Code Sec. 25A purposes (i.e., for purposes of the Hope credit and Lifetime learning credit), qualified tuition and related expenses included tuition and fees (excluding nonacademic fees) required to be paid to an eligible educational institution as a condition of enrollment or attendance of an eligible student at the institution.

For a tax year beginning in 2009 or 2010, ARRA substantially liberalized and modified the Hope credit (including renaming it the American opportunity tax credit). Under one modification, for purposes of Code Sec. 25A , ARRA changed the definition of qualified tuition and related expenses so that the term applies to tuition, fees, and course materials. (Code Sec. 25A(i)(3))

The technical corrections bill would modify Code Sec. 25A(i)(3) so that the inclusion of course materials in the definition of qualified tuition and related expenses applies only for purposes of the Hope (American opportunity) credit, not for purposes of the Lifetime learning credit.

Deduction for qualified motor vehicle taxes. The last sentence of Code Sec. 164(a) provides that certain taxes, such as sales tax, paid in connection with property used in a trade or business is treated as part of the cost of the property, or in the case of a disposition, as a reduction in the amount realized.

In connection with its creation of an itemized deduction or standard deduction for qualified motor vehicle taxes (for qualified purchases on or after Feb. 17, 2009 and before Jan. 1, 2010), ARRA provided that the last sentence of Code Sec. 164(a) did not apply to qualified motor vehicle taxes. (Code Sec. 164(b)(6)(E)) This was interpreted to mean that, presumably, a small business owner who timely bought a qualifying motor vehicle in 2009 may deduct the qualified motor vehicle tax (subject to the purchase price limitation and the income limitation) rather than add it to the cost of the property and recover it through depreciation or expensing.

The technical corrections bill would strike Code Sec. Code Sec. 164(b)(6)(E) as inoperative, because the taxes referred to in the last sentence of Code Sec. 164(a) do not include qualified motor vehicle taxes. The Joint Committee on Taxation's description of the technical corrections bill explains that, as in the case of the deduction for the general sales tax, it is intended that the deduction for qualified motor vehicle taxes ***not apply*** to tax on items used in a trade or business, although the tax may be deductible under another Code provision.

S corporation built-in gain holding period. Where a corporation that was formed as a C corporation elects 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 (35%) on all gains that were built-in at the time of the election if the gains are

recognized during the recognition period. Under pre-ARRA law, the recognition period was the first ten S corporation years (or during the ten-period after the transfer). Under a special exception, the recognition period was unlimited for distributions by thrift institutions that were deemed to be out of pre-'88 reserves. Gains are not built-in gains to the extent they are shown to have arisen while the S election was in effect or are offset by losses.

ARRA amended Code Sec. 1374(d)(7)(B) to provide that for tax years beginning in 2009 and 2010, no tax is imposed on the net unrecognized built-in gain of an S corporation if the seventh tax year in the recognition period preceded the 2009 and 2010 tax years. This rule applies separately for property acquired from C corporations in carryover basis transactions.

The technical corrections bill would amend Code Sec. 1374(d)(7)(B) to clarify that seven ***calendar*** years (not seven taxable years) in the 10-year recognition period must have elapsed prior to any taxable year beginning in 2009 or 2010 for an S corporation to be eligible for the built-in gains tax relief under ARRA.

15–year writeoff property and bonus deprecation. Under pre-EESA law, qualified leasehold improvements and qualified restaurant improvements placed in service before Jan. 1, 2008 could be written off over 15 years (instead of 39 years) via straight line. EESA extended the 15-year writeoff for both qualified leasehold improvement property and qualified restaurant property for two years, that is, it applies for eligible property placed in service through Dec. 31, 2009. (Code Sec. 168(e)(3)(E)) Additionally, for qualifying property placed in service after Dec. 31, 2008 and before Jan. 1, 2010, EESA also (1) liberalized the definition of qualified restaurant property, and (2) provided that any qualified retail improvement property placed in service after Dec. 31, 2008, and before Jan. 1, 2010, may be depreciated via straight line over 15 years under MACRS. (Code Sec. 168(e)(3)(E)) Under Code Sec. 167(e)(7) and Code Sec. 167(e)(8), bonus depreciation generally does not apply to property made eligible for the 15-year writeoff under the two EESA changes mentioned above.

The technical corrections bill amends Code Sec. 168(e)(7) and Code Sec. 167(e)(8) to clarify that assets qualifying as both qualified leasehold improvement property and either qualified restaurant property or qualified retail improvement property ***do*** qualify for bonus depreciation. The Joint Committee on Taxation description of the technical corrections bill says this change would be consistent with the legislative intent with respect to assets that overlap in this manner.

NQDC from certain tax-indifferent parties. Generally effective for amounts deferred which are attributable to services performed after 2008, EESA provided in Code Sec. 457A that any compensation that is deferred under a nonqualified deferred compensation (NQDC) plan of a nonqualified entity is includible in gross income by the service provider when there is no substantial risk of forfeiture of the service provider's rights to the compensation.

The technical corrections bill would clarify Code Sec. 457A to reflect legislative intent as to whether a partnership is a nonqualified entity. In determining whether a partnership is considered a nonqualified entity, an organization that is a partner in the partnership would not be considered exempt from U.S. income tax to the extent that the organization's share of the partnership's income is subject to U.S. tax as unrelated business taxable income. Similarly, a foreign person that is a partner in a partnership would not be considered a foreign person with respect to whom partnership income is not subject to a comprehensive foreign income tax to the extent that such person's share of partnership income is subject to U.S. income tax as income as income effectively connected with the conduct of a U.S. trade or business.

Entity aggregation rules similar to those that apply under Code Sec. 409A would apply for purposes of the provision.

The technical corrections bill also would clarify that:

- the aggregation rules do not treat every entity within an aggregated group as a nonqualified

entity merely because one entity in the group is a nonqualified entity.

- the rules of Code Sec. 457A defining substantial risk of forfeiture, not the rules defining it in Code Sec. 409A , apply for purposes of Code Sec. 457A.
- A service provider has the meaning given in the Code Sec. 409A regs, determined without regard to accounting method. Due to the definition of substantial risk of forfeiture under the provision, an accrual-basis taxpayer might be required to include compensation as income under the provision at a date earlier than the accrual accounting method rules would otherwise require.