RIA Special Study: Business Tax Provisions Retroactively Extended by the Tax Increase Prevention Act of 2014

Research Credit Extended

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.

The base amount is a fixed-base percentage of the taxpayer's average annual gross receipts from a U.S. trade or business, net of returns and allowances, for the 4 tax years before the credit year, and can't be less than 50% of the year's qualified research expenses. The fixed base percentage for a non-startup company is the percentage (not exceeding 16%) that taxpayer's total qualified research expenses are of total gross receipts for tax years beginning after '83 and before '89. A 3% fixed-base percentage applies for each of the first 5 tax years in which a "startup company" (one with fewer than 3 tax years with both gross receipts and qualified research expenses) has qualified research expenses.

A taxpayer can elect an alternative simplified research credit equal to 14% of the excess of the qualified research expenses for the tax year over 50% of the average qualified research expenses for the three tax years preceding the tax year for which the credit is being determined. If a taxpayer has no qualified research expenses in any one of the three preceding tax years, the alternative simplified research credit is 6% of the qualified research expenses for the tax year for which the credit is being determined.

Under pre-Act law, the research credit didn't apply for amounts paid or accrued after Dec. 31, 2013.

New law. TIPA retroactively extends the research credit for one year to apply to amounts paid or accrued before Jan. 1, 2015.

> **RIA recommendation:** Because the extension of the research credit is retroactive to include amounts paid or incurred after Dec. 31, 2013, taxpayers, such as fiscal year corporations that already filed returns for a fiscal year that includes part of 2014, or any other taxpayers that have filed returns for tax years ending after Dec. 31, 2013, 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.

dm-t
decoria • maichel • teague
P | 509.535.3503
F | 509.535.9391
7307 N. Division, Suite 222
Spokane, WA 99208
www.dm-t.com

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: veterans or non-veterans who began work after Dec. 31, 2013.

New law. TIPA retroactively extends the WOTC so that it applies to eligible veterans and nonveterans who begin work for the employer before Jan. 1, 2015.

Indian Employment Credit 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, 2013.

New law. TIPA retroactively extends the Indian employment credit for one year to tax years beginning before Jan. 1, 2015.

dm-t
decoria • maichel • teague
P | 509.535.3503
F | 509.535.9391
7307 N. Division, Suite 222
Spokane, WA 99208
www.dm-t.com

New Markets Tax Credit 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, 2011, 2012 and 2013. However, 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 2018.

New law. TIPA retroactively extends the new markets tax credit for one year, through 2014. It provides up to $3.5 billion in qualified equity investments for the 2014 calendar year. The carryover period for unused new markets tax credits is also extended for one year, through 2019.

Differential Wage Payment Credit for Employers 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. This differential wage payment credit is 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, 2013.

New law. TIPA retroactively extends the credit for one year to differential wages paid before Jan. 1, 2015.

P | 509.535.3503
F | 509.535.9391
7307 N. Division, Suite 222
Spokane, WA 99208
www.dm-t.com

Enhanced Deduction for Food Inventory Extended

A taxpayer engaged in a trade or business is eligible to claim an enhanced deduction for donations of food inventory. A C corporation's deduction equals 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. For a taxpayer other than a C corporation, 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, 2013.

New law. TIPA retroactively extends the apparently wholesome food contribution rules for one year to contributions made before Jan. 1, 2015.

Domestic Production Activities Deduction Rules for Puerto Rico Extended

Under the **Code Sec. 199** domestic production activities deduction, a taxpayer is allowed a deduction from taxable income (or adjusted gross income, in the case of an individual) that is equal to 9% of the lesser of the taxpayer's qualified production activities income (QPAI) or taxable income for the tax year. QPAI is generally domestic production gross receipts (DPGR) reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts; and (2) other expenses, losses, or deductions which are properly allocable to those receipts. The amount of the deduction for a tax year is limited to 50% of the wages paid by the taxpayer, and properly allocable to DPGR, during the calendar year that ends in the tax year. Wages paid to bona fide residents of Puerto Rico generally are not included in wages for purposes of computing the wage limitation amount.

A taxpayer has 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 eight years of a taxpayer beginning after Dec. 31, 2005 and before Jan. 1, 2014, 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. In computing the 50% wage limitation, the taxpayer was allowed to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico.

New law. TIPA extends the special domestic production activities rules for Puerto Rico for one year through 2014. Under the Act, these special rules for Puerto Rico apply for the first nine tax years of a taxpayer beginning after Dec. 31, 2005 and before Jan. 1, 2015.

Subpart F Exception for Active Financing Income Extended

The U.S. parent of a foreign subsidiary engaged in a banking, financing, or similar business is eligible for deferral of tax on that subsidiary's earnings if the subsidiary is predominantly engaged in that business and conducts substantial activity with respect to the business. The subsidiary also has to pass an entity level income test to demonstrate that the income is active income and not passive income. Thus, this 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") is excluded from the definition of Subpart F income.

Under pre-Act law, this exception applied for tax years of foreign corporations 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 the foreign corporations end.

New law. TIPA retroactively extends the exclusions for active financing income for one year to tax years of a foreign corporation beginning after Dec. 31, 2013 and before Jan. 1, 2015, and tax years of U.S. shareholders with or within which such tax years of foreign corporations ended.

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

For tax years beginning before Jan. 1, 2014, dividends, interest, rents, and royalties received by one controlled foreign corporation (CFC) from a related CFC are 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).

dm-t
decoria • maichel • teague
P | 509.535.3503
F | 509.535.9391
7307 N. Division, Suite 222
Spokane, WA 99208
www.dm-t.com

Under pre-Act law, this look-thru rule applied to tax years of foreign corporations beginning after Dec. 31, 2005 and before Jan. 1, 2014, and to tax years of U.S. shareholders with or within which such tax years of foreign corporations ended.

New law. TIPA retroactively extends look-through treatment for related CFCs for one year, to tax years of a foreign corporation before Jan. 1, 2015, and tax years of U.S. shareholders with or within which such tax years of foreign corporations end.

Reduction in S Corp Recognition Period for Built-In Gains Tax 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 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 (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 2012 and 2013, the recognition period was five years (instead of the generally applicable ten year period). Thus, the recognition period was the five-year period beginning with the first day of the first tax year for which the corporation was an S corporation (or beginning with the date of acquisition of assets if the rules applicable to assets acquired from a C corporation applied). If an S corporation disposed of such assets in a tax year beginning in 2012 or 2013 and the disposition occurred more than five years after the first day of the relevant recognition period, gain or loss on the disposition wasn't taken into account in determining the net recognized built-in gain.

New law. TIPA provides that for determining the net recognized built-in gain for tax years beginning in 2014, the recognition period is a 5-year period-the same rule that applied to tax years beginning in 2012 and 2013.

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 Sept. 27, 2010 and before Jan. 1, 2014. None of the excluded gain is subject to the alternative minimum tax.

Under pre-Act law, the exclusion was to be limited to 50% of gain for stock acquired after Dec. 31, 2013, and 7% of the excluded gain was to be an alternative minimum tax preference.

New law. The Act extends the 100% exclusion and the exception from minimum tax preference treatment for one year (i.e., for stock acquired before Jan. 1, 2015).

Lower Shareholder Basis Adjustments for Charitable Contributions by S Corporations 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, 2013.

New law. TIPA retroactively extends the PPA rule for one year so that it applies for contributions made in tax years beginning before Jan. 1, 2015.

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

For 2006-2013, interest, rent, royalties, and annuities paid to a tax-exempt organization from a controlled entity are excluded from the unrelated business taxable income (UBTI) of the tax-exempt organization, to the extent the payment reduced the net unrelated income (or increased any net unrelated loss) of the controlled entity.

For payments made pursuant to a binding written contract in effect on Aug. 17, 2006 (or renewal of such a contract on substantially similar terms), the above rule applies only to the portion of payments received or accrued in a tax year that exceeds the amount of the payment that would have been paid or accrued if the amount of such payment had been determined under the principles of **Code Sec. 482** (i.e., at arm's length). A 20% penalty applies to that excess.

Under pre-Act law, these rules didn't apply to payments received or accrued after Dec. 31, 2013.

New law. TIPA retroactively extends these rules for one year, so that they apply for payments received or accrued by a tax-exempt organization through Dec. 31, 2014

dm-t
decoria • maichel • teague
P | 509.535.3503
F | 509.535.9391
7307 N. Division, Suite 222
Spokane, WA 99208
www.dm-t.com

dm-t | news

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. A taxpayer holding a qualified zone academy bond on the "credit allowance date" is entitled to a credit.

Under pre-Act law, except for carryovers of unused issuance limitations, the national bond volume limitation was $400 million for 2011, 2012, and 2013.

New law. TIPA provides that the national bond volume limitation is $400 million per year for 2011 through 2014.

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

Under pre-Act law, a regulated investment company (RIC) may 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 corporation 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 are generally not taxable when received by a nonresident alien individual or foreign corporation and aren'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, 2013.

New law. TIPA retroactively extends 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, 2015.

Treatment of RIC As Qualified Investment Entity 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 the Foreign Investment in Real Property Tax Act (FIRPTA) provisions. A USRPI does not include an interest in a domestically controlled "qualified investment entity."

dm-t
decoria • maichel • teague
P | 509.535.3503
F | 509.535.9391
7307 N. Division, Suite 222
Spokane, WA 99208
www.dm-t.com

Under pre-Act law, before Jan. 1, 2014, a RIC that met certain requirements could be treated as a "qualified investment entity."

New law. TIPA retroactively extends the inclusion of a RIC within the definition of a "qualified investment entity" for one year, through Dec. 31, 2014.

The change made by Act. Sec. 133(a) generally takes effect on Jan. 1, 2014, but the Act doesn't impose a withholding requirement under **Code Sec. 1445** for any payment made before its enactment. A RIC that withheld and remitted tax under **Code Sec. 1445** on distributions made after Dec. 31, 2013 and before the enactment date isn't liable to the distributee for such withheld and remitted amounts. (Act Sec. 133(b))

Empowerment Zone Tax Breaks 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, 2013.

New law. TIPA extends for one year, through Dec. 31, 2014, the period for which the designation of an empowerment zone is in effect.

For a designation of an empowerment zone, the nomination for which included a termination date of Dec. 31, 2013, 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. 139(b))

Miscellaneous Other Provisions Repealed, Modified, or Extended

TIPA retroactively extends:

- the low-income housing 9% credit rate freeze for allocations made before Jan. 1, 2015
- for one year through 2014 a provision under which the basic housing allowance of a military member is excluded from income for purposes of determining the individual's qualification as a "low-income tenant" for purposes of the low-income housing tax credit program.
- the railroad track maintenance credit for one year through 2014.
- the mine rescue team training credit for one year through 2014,
- the increase in the $10.50 per gallon limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands for one year through 2014.
- the possessions tax credit for American Samoa for one year through 2014.
- automatic extension of amortization periods for multiemployer defined benefit pension plans

shortfall funding method for plans in endangered or critical status.

dm-t
decoria • maichel • teague
P | 509.535.3503
F | 509.535.9391
7307 N. Division, Suite 222
Spokane, WA 99208
www.dm-t.com