

American Jobs and Closing Tax Loopholes Act (H.R. 4213)

June 1, 2010

Special Report

HIGHLIGHTS

- \$56 Billion Revenue Offsets
- \$40 Billion Extenders Relief
- Individual/Business Incentives
- Energy Extenders
- National Disaster Relief
- International Reforms
- Change in Taxation of Carried Interest
- Foreign Tax Credit Reforms
- And More

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House Passes Tax Extenders; Nixes COBRA Subsidy

Unable to win support for the leadership-endorsed “American Jobs and Closing Tax Loopholes Act” (H.R. 4213), House Democrats passed an abbreviated, yet still substantial, extenders bill on May 28 by a vote of 215 to 204. The bill extends many temporary individual, business, energy, and charitable tax incentives through the end of 2010. The bill retains a controversial revenue raiser, a change in the taxation of carried interest. The bill also retains a package of international taxation reforms. To keep the cost of the bill down, House lawmakers jettisoned, among other things, an extension of eligibility for COBRA premium assistance.

IMPACT. Democratic leaders in the House were keen to portray the tax extenders bill as a “jobs” bill, reflecting their emphasis on job creation in 2010 after passage of the Hiring Incentives to Restore Employment (HIRE) Act earlier this year. However, fiscal conservatives were troubled by the bill’s price tag and the fact that it wasn’t fully offset. They flexed their power by refusing to endorse the original bill and insisting that any bill that passes be fully offset.

COMMENT. Senate Majority Leader Harry Reid, D-Nevada, had promised to keep the Senate in session over Memorial Day weekend, if necessary, to pass the extenders bill. However, the Senate wrapped up its business on May 28 without taking up the extenders bill. Senior Democrats in the Senate have indicated that the Senate will take up the House extenders bill when it returns from its Memorial Day recess after June 7. The House and Senate also may take up an extension of COBRA premium assistance after June 7.

COMMENT. Despite sharp criticism from the real estate and investment sectors, supporters of the bill were able to win approval for a change in the taxation of carried interest. However, the bill as passed by the House delays the effective date until 2011. While the core group of one-year extensions of individual and business tax benefits has virtually no opposition in the Senate, the sticking point remains over how they will be paid for in the form of revenue offsets. Opponents also argue that the revenue raisers are permanent tax increases for temporary incentives.

INDIVIDUAL EXTENDERS

The House bill provides one-year extensions to a handful of individual tax incentives that expired after December 31, 2009. The extensions are retroactive to January 1, 2010 and apply to calendar year 2010. The individual extenders are identical to those passed by the Senate in March 2010.

COMMENT. Certain extenders affecting individuals are also covered within this Tax Briefing under “Charitable Provisions,” “Energy Extenders,” and “National Disaster Relief.”

COMMENT. The House bill directs the Joint Committee on taxation to submit a report on each tax expenditure extended by the bill to the House Ways and Means Committee.

Additional Standard Deduction for Real Property Taxes

Prior to January 1, 2010, individuals who did not itemize their deductions could claim an additional standard deduction for all or part

of their qualified state and local real property taxes, up to \$500. For married couples filing a joint return, the maximum deduction was \$1,000. The additional standard deduction for state and local real property taxes expired after December 31, 2009. The House bill extends this additional standard deduction through December 31, 2010.

IMPACT. *The \$500/\$1,000 deduction does not lower the taxpayer's adjusted gross income (AGI). This amount is added to the standard deduction.*

IMPACT. *Taxpayers who have paid or are close to paying off their home mortgages or who otherwise have few itemized deductions may benefit from the additional standard deduction for real property taxes.*

State and Local Sales Tax Deduction

The American Jobs Creation Act of 2004 and subsequent legislation allowed taxpayers the option of taking an itemized deduction for either: (1) state and local income taxes or (2) state and local general sales taxes. The state and local sales tax deduction expired after December 31, 2009. The House bill extends this election through December 31, 2010.

PLANNING NOTE. *Taxpayers can calculate their state and local sales tax deduction either by saving receipts or using the Optional State Sales Tax Tables provided by the IRS. Taxpayers residing in states with no income tax are likely to benefit from this election.*

COMMENT. *Taxpayers are free to deduct state and local income taxes in one tax year and state and local general sales taxes in another tax year.*

Higher Education Tuition Deduction

Before January 1, 2010, qualified taxpayers could take an above-the-line deduction for

qualified higher education tuition and related expenses. The maximum deduction of \$4,000 went to qualified taxpayers with adjusted gross income (AGI) not exceeding \$65,000 (\$130,000 for joint filers). A reduced deduction of up to \$2,000 was available to qualified taxpayers with AGI up to \$80,000 (\$160,000 for joint filers). The higher education tuition deduction expired after December 31, 2009. The House bill extends the incentive through December 31, 2010.

COMMENT. *Elementary and secondary education expenses are not deductible.*

COMMENT. *The House bill clarifies that the deduction is unavailable to a taxpayer for whom a credit for higher education under Code Sec. 25A (the HOPE and Lifetime Learning Credits) would have provided a greater net reduction in tax liability, without regard to any disallowance or reduction in the credit's value as a result of the AMT.*

CAUTION. *If an education expense is deductible under any other provision, such as the American Opportunity Tax Credit (AOTC) or Lifetime Learning Credit, a taxpayer cannot claim a double tax benefit.*

Teacher's Classroom Expense Deduction

Teachers, principals, guidance counselors, and other education professionals working in kindergarten through twelfth grade were able to deduct qualified out-of-pocket classroom expenses before January 1, 2010. The deduction was above-the-line with a \$250 maximum. Eligible expenses included the costs of supplies, equipment, books, and software used in the classroom. The teacher's classroom expense deduction expired after December 31, 2009. The House bill extends the incentive through December 31, 2010.

PLANNING NOTE. *The teacher's classroom expense deduction has a \$250 annual ceiling. If a qualified taxpayer itemizes deductions, the taxpayer may be able to deduct classroom expenses that exceed*

the \$250 cap as an employment-related miscellaneous itemized deduction subject to the two-percent floor.

BUSINESS EXTENDERS

The House bill also extends many temporary business tax incentives, which expired after December 31, 2009, through tax years ending on December 31, 2010. These extenders are almost identical to those passed by the Senate in March 2010.

COMMENT. *If the Senate opts to amend the House extenders bill, rather than approve it without amendment, GOP lawmakers are expected to push for an extension of bonus depreciation into 2010.*

Research Tax Credit

Code Sec. 41 provides a tax credit for qualified research and experimentation (R&E) expenditures. The research tax credit expired after December 31, 2009. The House bill extends the research credit for one year, for amounts paid or incurred through December 31, 2010.

IMPACT. *Taxpayers and Congress agree that a permanent research tax credit would better jump start the long-term investments needed to maximize research funding. However, the revenue cost of a permanent credit is prohibitive to the overall extenders bill. The one-year R&E extension is by far the most expensive in the House bill costing \$6.65 billion.*

Refundable AMT Credits

The House bill allows business taxpayers to elect to apply 10 percent of unused alternative minimum tax (AMT) credits toward qualified investments in domestic manufacturing facilities and equipment in 2010.

Differential Pay Credit

Qualified small businesses could take a 20-percent tax credit for differential wages up to \$20,000 paid to qualified

employees who are called to active military duty. The differential wage payment credit, which initially applied to amounts paid after June 17, 2008, expired after December 31, 2009. The House bill extends the incentive through December 31, 2010.

COMMENT. *A qualified small business for purposes of the differential wage payment credit is a business with fewer than 50 employees.*

Qualified Leasehold Improvements

In the American Jobs Creation Act of 2004, Congress authorized a 15-year recovery period under the Modified Accelerated Cost Recovery System (MACRS) for qualified leasehold improvement property placed in service after October 22, 2004 and before January 1, 2006, using the straight-line method and the half-year convention unless the mid-quarter convention applies. Subsequent legislation extended this treatment to apply to qualified leasehold improvement property placed in service before January 1, 2010. The House bill extends this treatment to apply to qualified leasehold improvement property placed in service before January 1, 2011.

IMPACT. *Unless this measure is extended, a leasehold improvement placed in service in 2010 will be depreciated over 39 years using the straight-line method beginning in the month the improvement was placed in service.*

Qualified Restaurant Property

Congress created a new category of 15-year property under MACRS called “qualified restaurant property” in the American Jobs Creation Act of 2004. Subsequent legislation extended the 15-year MACRS recovery period for qualified restaurant improvement property placed in service before January 1, 2010. The House bill extends the 15-year MACRS recovery period for qualified

restaurant improvement property placed in service before January 1, 2011.

Retail Improvement Property

Qualified retail improvement property placed in service in 2009 was treated as MACRS 15-year property. This temporary measure expired after December 31, 2009. The House bill extends the 15-year MACRS recovery period for qualified retail improvement property that is placed in service before January 1, 2011.

“The ‘American Jobs and Closing Tax Loopholes Act’ (H.R. 4213) includes more than 50 individual, business, charitable, and energy extenders and more.”

COMMENT. *Congress provided for a new category of MACRS, qualified retail improvement property, to extend the benefits provided for qualified leasehold improvements to retail properties that are owner-occupied.*

Indian Employment Credit

The Indian Employment Credit provides a credit to employers of qualified employees who work and live on or near an Indian reservation. The credit is 20 percent of the excess of current wages and health insurance costs paid to qualified employees over the amounts paid in 1993. The total amount of qualified wages and employee health insurance costs (except any amount paid or incurred for health insurance under a salary reduction arrangement) used to calculate the credit cannot exceed \$20,000 per employee per tax year. The Indian Employment Credit expired after December 31, 2009. The House bill extends the Indian Employment credit for wages paid or incurred through December 31, 2010.

COMMENT. *The House bill also extends accelerated depreciation for qualified Indian reservation property.*

COMMENT. *The qualified employee for purposes of the Indian Employment Credit must be an enrolled member of a Native American tribe or the spouse of an enrolled member of a Native American tribe. Additionally, the qualified employee must perform substantially all of his or her services for the employer within an Indian reservation, and have his or her main home on or near that reservation.*

Film and Television Production Costs

For productions commenced before January 1, 2010, qualified taxpayers could elect to deduct the first \$15 million of qualified film and television production costs in the year the expense is incurred in lieu of capitalizing the costs through depreciation allowances. This treatment expired after December 31, 2009. The House bill extends the incentive through December 31, 2010.

Environmental Remediation

Before January 1, 2010, businesses could elect to treat qualified environment/brownfields remediation expenditures as deductible in the year paid or incurred. The House bill extends expensing of environment/brownfields remediation costs to expenses incurred before January 1, 2011. Additionally, the House bill extends the exclusion of gain or loss on the sale or exchange of certain brownfield sites from unrelated business taxable income.

Regulated Investment Companies

Several temporary provisions applying to regulated investment companies (mutual funds) and their shareholders expired after December 31, 2009. The provisions included measures with respect to interest-related dividends and

short-term capital gains dividends of mutual funds; the look through of certain mutual fund stock for purposes of determining the gross estate of nonresidents who are not U.S. citizens; and the treatment of a mutual fund investing in real estate as a qualified investment entity with respect to dispositions of investments in U.S. real property. The House bill extends these measures through December 31, 2010.

Active Financing Income/Look-Through

Generally, U.S. shareholders of a controlled foreign corporation (CFC) are subject to tax on certain income earned by the CFC even if the income is not currently distributed. Past legislation has provided exceptions from Subpart F. These exceptions include “active financing” exceptions for certain income derived in the active conduct of a banking, financial, insurance, or similar business. Past legislation has also provided for look-through exceptions for certain dividends, interest, rents, and royalties received by one CFC from a related CFC. These measures expired after December 31, 2009. The House bill extends the exceptions for active financing and the look-through exceptions through December 31, 2010.

More Extenders

The House extenders bill would also extend through December 31, 2010, the following business provisions:

- Five-year write-off of farm machinery/equipment;
- Mine rescue training credit;
- Election to expense mine safety equipment;
- Railroad track maintenance credit;
- Real estate investment trust (REIT) timber treatment;
- Seven-year motorsports entertainment cost recovery;
- Tax incentives for empowerment zones;
- Tax incentives for investment within the District of Columbia;
- Renewal community tax incentives;
- Modification of tax treatment of certain payments to controlling exempt organizations;

- Code Sec. 199 domestic production activities deduction for qualified activities in Puerto Rico;
- Temporary increase in limit on cover over of rum excise taxes to Puerto Rico and the U.S. Virgin Islands; and
- American Samoa Economic Development Credit.

COMMENT. The House bill also allows taxpayers to claim the mine rescue training credit and bonus depreciation allowance against alternative minimum tax (AMT).

CHARITABLE EXTENDERS

The House bill extends a number of tax incentives to encourage contributions to charitable organizations by individuals and businesses. Similar provisions are in the Senate’s March 2010 extenders bill.

IRA Contributions to Charity

Before January 1, 2010, individuals aged 70 1/2 or above could distribute up to \$100,000 from their IRAs to a charitable organization without recognizing income and without having to take an itemized charitable deduction that ordinarily carries specific contribution-based limitations. The House bill extends the provision for qualified charitable distributions from IRAs through December 31, 2010.

IMPACT. The measure does not apply to ongoing SEP or SIMPLE IRAs, or to inherited IRAs if the beneficiary reached age 70 1/2 before the distribution.

Conservation Contributions of Real Property

The Heartland, Habitat, Harvest, and Horticulture Act of 2008 extended special rules for contributions of real property for conservation purposes, originally enacted in the Pension Protection Act of 2006, through December 31, 2009. Under those provisions, an individual donor could take a deduction for a

qualified conservation contribution to a Code Sec. 170(b)(1)(A) eligible organization to the extent that the aggregate of such contributions does not exceed 50 percent of the donor’s contribution base over the amount of all other charitable contributions allowable under Code Sec. 170(b)(1). Excess amounts could be carried over for up to 15 years. The House bill extends these special rules for contributions of real property for conservation purposes to contributions made through December 31, 2010.

COMMENT. In the case of an individual who is a qualified farmer or rancher for the tax year in which the contribution is made, a qualified conservation contribution is allowable up to 100 percent of the excess of the taxpayer’s contribution base over the amount of all other allowable charitable contributions.

Contributions of Food Inventory

The enhanced deduction for charitable contributions of food inventory expired after December 31, 2009. The House bill extends the enhanced deduction for charitable contributions of food inventory through December 31, 2010.

COMMENT. Donations of food must consist of “apparently wholesome food,” which is food intended for human consumption that meets all quality and labeling standards imposed by federal state and local laws and regulations, even though the food may not be marketable due to appearance, age, freshness, grade, size, surplus, or other conditions.

Contributions of Book Inventory to Public Schools

Qualified corporations may take a special deduction for qualified book contributions to public schools. The special deduction for qualified book contributions by qualified corporations to public schools expired after December 31, 2009. The House bill extends the deduction for qualified book contributions by C corporations to public schools made during tax years beginning on or before December 31, 2010.

CAUTION. *S corporations cannot take this special deduction for qualified book contributions to a public school.*

COMMENT. *A qualified book contribution is a charitable contribution of books to a public school providing elementary or secondary education with a regular faculty and a regularly enrolled student body.*

Contributions of Computer Inventory

Contributions of computer technology and equipment by a corporation for educational purposes may qualify for a special deduction equal to the corporate donor's basis in the donated property plus one-half of the ordinary income that would have been realized if the property had been sold. This special treatment expired after December 31, 2009. The House bill extends the enhanced deduction for contributions of computer technology and equipment by a corporation for educational purposes through December 31, 2010.

S Corps' Charitable Contributions

For tax years beginning after 2005 and before 2010, a shareholder's basis in the stock of an S corp making a charitable contribution was reduced by the shareholder's pro rata share of the adjusted basis of the contributed property, rather than the less favorable pro rata share of the fair market value of the contributed property. The House bill extends this basis adjustment treatment through December 31, 2010.

Controlling Exempt Organizations

The House bill extends through December 31, 2010 special rules for interest, rents, royalties, and annuities received by an exempt entity from a controlled entity.

ENERGY EXTENDERS

The House bill extends several temporary energy tax incentives. The energy incentives are also in the Senate's March 2010 extenders bill.

COMMENT. *Members of Congress have attributed the failure to renew certain energy tax incentives earlier this year with causing job layoffs, especially in the energy production sector.*

Alternative Motor Vehicle Credit for Heavy Hybrids

Hybrid vehicles that use gasoline and electricity may qualify for an alternative motor vehicle credit. Separate credits are available for automobiles and light trucks; and medium and heavy trucks. The credit, available generally since 2006, ends after 2009, 2010 or 2014, depending on the type of vehicle. The bill extends these end dates, respectively, for one year.

Credits for Biodiesel and Renewable Diesel Fuel

The Tax Code provides for a biodiesel credit, a biodiesel small producer credit and a biodiesel excise credit, which expired at the end of 2009. The bill extends the income tax credit, excise tax credit and payment provisions for biodiesel and renewable diesel through December 31, 2010.

Credits for Natural Gas/Liquefied Petroleum Gas Used as Transportation Fuel

The House bill extends the alternative fuel production credit and payment provisions for compressed and liquefied natural gas and natural gas and liquefied petroleum gas through December 31, 2010.

Sales of Electric Transmission Property

Vertically integrated electric utilities can defer gain up to eight years when they sell qualified electric transmission property to qualified independent transmission companies and subsequently reinvest the proceeds in certain natural gas or electricity production. The House bill extends the deferral provision to sales before January 1, 2011.

The House bill also:

- Modifies the standards for energy-efficient windows, doors and skylights eligible for the Code Sec. 25C residential energy property credit;
- Extends the new energy efficient home credit for eligible contractors and producers of manufactured homes;
- Extends the placed-in-service date for the steel industry fuel tax credit;
- Extends the placed-in-service date for eligibility for a tax credit for the production of coke or coke gas;
- Extends suspension of the limitation on percentage depletion for oil and gas from marginal wells;
- Extends the credit for electricity produced at qualified open-loop biomass facilities; and
- Provides tax-free direct payments in lieu of tax credits to manufacturers of qualified energy efficient appliances at 85 percent of the Code Sec. 45M tax credit.

IMPACT. *The House bill modifies the Code Sec. 25C residential energy property credit but does not extend the credit. In 2009 and 2010, an individual may claim a credit (up to \$1,500) for 30 percent of the cost of installing energy-efficient exterior windows, doors and skylights; energy-efficient heating and air conditioning systems, insulation, water heaters (natural gas, propane or oil); roofs (metal and asphalt); and biomass stoves. The House bill modifies the credit by linking eligibility for the tax credit to the Energy Star requirements.*

NATIONAL DISASTER RELIEF

Traditionally, disaster relief has been enacted on a disaster-by-disaster basis. In 2008, Congress passed the National Disaster Relief Act (2008 Disaster Relief Act). The 2008 Disaster Relief Act provided a variety of temporary provisions to assist taxpayers nationwide recovering from a qualified disaster. The House bill extends the national disaster relief provisions through December 31, 2010.

COMMENT. *A federally declared disaster is a disaster occurring in an area that is*

determined by the President to warrant assistance by the federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

Losses Attributable to Federal Disasters

Prior to January 1, 2010, the 10 percent of AGI limitation applicable to personal casualty loss deductions was waived for personal "net disaster losses." A net disaster loss is the excess of the personal casualty losses occurring in a disaster area and attributable to a federally declared disaster after 2007 and before 2010, over personal casualty gains. The House bill extends this treatment through December 31, 2010.

CAUTION. *One provision in the House bill's "disaster assistance" section is not pro-taxpayer. The 2008 Disaster Relief Act increased the amount by which all individuals claiming casualty losses must reduce their personal casualty losses from each casualty event from \$100 to \$500 for tax years beginning after December 31, 2008 and ending before January 1, 2010. Under current law, the reduction is \$100 for tax years beginning after December 31, 2009. The House bill extends the \$500 deductible for each casualty loss through December 31, 2010.*

COMMENT. *A taxpayer may elect to deduct a casualty loss in a federally-declared disaster area on his or her return for the immediately preceding tax year to accelerate the benefit.*

Special Depreciation Allowance for Disaster Property

The 2008 National Disaster Act provides an additional 50-percent bonus depreciation deduction on property that rehabilitates or replaces qualified business property damaged by a federally declared disaster. This treatment expired after December 31, 2009. The House bill extends the measure for property placed in service in a qualified disaster area before January 1, 2011.

NOLs Attributable to Disasters

The 2008 National Disaster Act provides a five-year net operating loss (NOL) carryback for qualified federally-declared disaster losses. The five-year NOL carryback for qualified disaster losses expired after December 31, 2009. The House bill extends the five-year NOL carryback for qualified disaster losses through December 31, 2010.

PLANNING NOTE. *Taxpayers can elect to disregard the five-year carryback rule for their qualified disaster loss. The normal two-year carryback period would then apply.*

Current Deduction of Disaster Expenses

The 2008 National Disaster Act allows qualified businesses to currently deduct rather than capitalize qualified disaster clean-up and repair expenses. Generally, these expenses are related to the clean up or repair of property from damage caused by a federally declared disaster. This treatment expired after December 31, 2009. The House bill extends this treatment through December 31, 2010.

COMMENT. *Qualified disaster expenses for purposes of the enhanced deduction are expenses paid or incurred in connection with a trade or business or business-related property that otherwise must be capitalized and that are for (1) the abatement or control of hazardous substances that were released on account of a federally declared disaster; (2) debris removal or demolition of structures on real property damaged or destroyed by a federally declared disaster; or (3) repair of business-related property damaged by a federally declared disaster.*

Qualified Mortgage Bonds

The 2008 National Disaster Act waives certain mortgage revenue bond requirements where an affected taxpayer's principal residence is destroyed or damaged as a result of a federally-declared disaster. The House bill extends this provision through December 31, 2010.

PENSION FUNDING RELIEF

Since passage of the Pension Protection Act of 2006 (PPA), some pension plans have struggled to remain healthy, especially during the economic slowdown. The House bill includes several pension funding relief measures for both single employer and multiemployer plans. The pension funding measures in the House bill generally mirror the pension funding provisions in the Senate's March 2010 extenders bill.

IMPACT. *While couched in terms of "relief," several of the pension funding provisions raise significant revenue. The single-employer plan provisions could raise \$1.3 billion over 10 years; the multiemployer provisions would raise \$800 million over 10 years principally because smaller required contributions would mean lower deductions.*

IMPACT. *The funding relief provisions do not waive or alter an employer's obligation to fully fund its pension plan but do offer a troubled employer additional time to meet its pension funding obligations.*

Single Employer Plans

Eased funding rules. Defined benefit plans are subject to minimum funding rules that require the employer to make annual contributions to fund plan benefits. If a single-employer plan is underfunded, the plan has a funding shortfall that must be amortized in level installments over seven years, beginning with the current plan year.

Under the House bill, a sponsor of a single-employer defined-benefit plan may elect to amortize the shortfall under two alternative extended amortization schedules – a nine-year period (two plus seven) or a 15-year period – that begin with the election year. The nine-year period requires the payment of interest only in the first two years, followed by level installments in the remaining seven years. Level annual installments would be required for the 15-year period. The installments must be increased if an employer pays excess compensation, extraordinary dividends or redeems stock. Plan sponsors may elect

relief for up to two plan years during the four-plan-year period from 2008-2011.

Plans subject to prior funding rules. The PPA's funding rules were delayed for multi-employer plans of certain cooperatives, PBGC settlement plans, and single-employer plans of government contractors. The House bill offers two types of funding relief to underfunded plans with delayed PPA effective dates. A plan can elect either reduced additional funding requirements or a 15-year amortization period.

COMMENT. The bill also delays the PPA effective date and provides special interest rate rules for eligible national charities and their local chapters. The charity provisions apply to plan years beginning after December 31, 2007.

Lookback for benefit restrictions. The PPA limits benefit payments and accruals for plans whose adjusted funding target attainment percentage (AFTAP) is less than 60 percent. The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) provided relief for plan years beginning during the period October 1, 2008 through September 30, 2009 by substituting the plan's AFTAP from the plan's preceding plan year. The House bill extends the WRERA relief to plan years beginning through 2011. The relief allows a plan to apply its AFTAP for the last plan year beginning before September 30, 2009.

Minimum contributions. A plan may apply a prior year's credit balance (amounts exceeding minimum contributions) to a later year's required minimum contributions, unless the plan is less than 80 percent funded. Under the House bill, for the period 2009 to 2011 a single-employer defined benefit plan may offset its minimum required contributions by a credit balance if the plan was at least 80 percent funded.

The House bill permits the payment of benefits as a Social Security leveling payment, which otherwise would be prohibited, for 2010 and 2011. The bill also temporarily permits employers to contribute shutdown benefits without having to waive pre-funding credit balances.

PBGC reporting. The House bill requires a plan sponsor to provide fee information to the PBGC if the sponsor's plan has unfunded vested benefits exceeding \$75 million. Under current law, additional reporting is required if the plan's funding percentage is below 80 percent.

Airline bankruptcy. The House bill permits airline employees to roll over bankruptcy settlement amounts to a traditional IRA (in addition to Roth IRAs), and to recharacterize a prior settlement contribution to a Roth IRA as a contribution to a traditional IRA.

Multiemployer Plans

A multiemployer plan is a plan to which more than one employer must contribute and which is maintained under a collective bargaining agreement. Multiemployer plans must amortize net experience losses over 15 years. The House bill allows plans to elect a 30-year period for certain losses incurred in either of the first two plan years ending on or after June 30, 2008. The bill also extends the maximum smoothing period for determining plan asset values from five years to 10 years for the first two plan years ending on or after June 30, 2008.

Endangered or critical status. The PPA imposes additional funding requirements on multiemployer plans that are in "endangered or critical status." Plans must adopt a 10-year funding improvement plan or a rehabilitation plan. WRERA provided an additional three-year period for these plans. The House bill permits a five-year extension, or two additional years for a plan that elected WRERA relief. If the collective bargaining parties cannot agree on a contribution schedule, the bill would allow plan trustees to elect a schedule approved for at least 75 percent of the employees participating in the plan. The provision will not apply to plan years beginning after 2014.

Amortization waivers. Plans that have received amortization waivers under pre-PPA law may treat the return on plan assets for plan years including any of the period June 30–October 31, 2008 as the interest rate used for charges and credits to the plan's funding standard account.

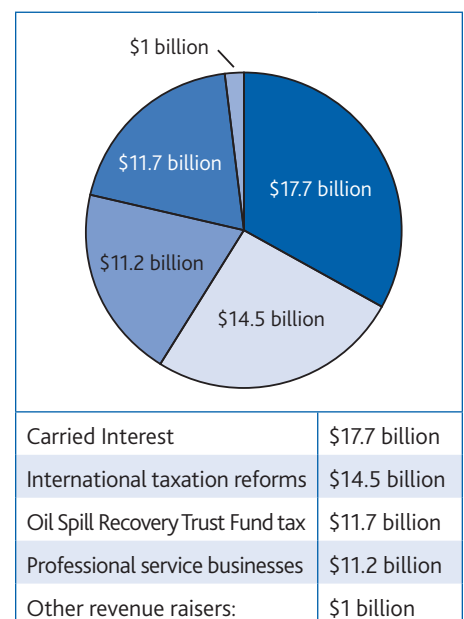
Certification. The House bill provides transition rules for certifications of a plan's funded status.

COMMENT. The House bill also includes a package of defined contribution fee disclosure rules for plan years beginning after December 31, 2011, with a reasonable good faith interpretation of the provision allowed until 12 months after final regulations are issued.

COBRA PREMIUM ASSISTANCE

COBRA allows qualified individuals to extend employer-provided group health coverage, if they would otherwise lose the coverage due to certain events such as loss of a job. The COBRA premium may be higher than individual's premium while employed, but is generally lower than that for private, individual health insurance coverage. The American Recovery and Reinvestment Act of 2009 (2009 Recovery Act) and subsequent legislation temporarily reduced the premium for COBRA or comparable state continuation coverage (mini-COBRA) for assistance eligible individuals.

REVENUE RAISERS OVER 10 YEARS



Generally, an assistance eligible individual is an employee or a member of the employee's family who elects COBRA coverage timely following a qualifying event related to an involuntary termination of employment occurring between September 1, 2008 through May 31, 2010. Assistance eligible individuals pay 35 percent of their COBRA premium costs and are treated as paying the full amount. Employers are reimbursed for their 65 percent portion of the premium payment through a payroll tax credit.

The Continuing Extension Act of 2010 (CEA), signed by President Obama on April 15, 2010, extended eligibility for COBRA premium assistance through May 31, 2010. The House bill, as modified on May 27, would have extended eligibility for the COBRA subsidy through November 30, 2010. A COBRA subsidy extension, however, did not survive the final version of the House bill that was passed on May 28, due to the significant costs that would have been added to the overall bill. Nevertheless, the House must deal with a COBRA subsidy extension when it returns from its Memorial Day recess.

COMMENT. *Under current law, individuals who lost health coverage because of a reduction of hours between September 1, 2008 through May 31, 2010 may be eligible for COBRA premium assistance if the employee is subsequently involuntarily terminated on or after March 2, 2010 and on or before May 31, 2010.*

EXAMPLE. *ABC Co. requires individuals electing COBRA premium continuation coverage to pay \$500 per month. Erin, an assistance eligible individual, is entitled to COBRA continuation coverage upon the timely payment of 35 percent of \$500 (\$175). ABC's payroll credit is 65 percent of \$500 (\$325). ABC claims the credit on its Form 941, Employer's Quarterly Federal Tax Return.*

PLANNING NOTE. *Employers use Form 941 to report their COBRA premium assistance payments. Small employers that file Form 944, Employer's Annual Federal Tax Return, which are generally those with an estimated employment tax liability of*

\$1,000 or less in the calendar year, may claim their COBRA credit on Form 944. Additionally, agricultural employers may claim the COBRA credit on Form 943, Employer's Annual Federal Tax Return for Agricultural Employees.

CAUTION. *If an individual is eligible for other group health coverage (such as coverage under a spouse's plan) or Medicare, the individual cannot claim the subsidy.*

PLANNING NOTE. *COBRA premium assistance phases out for higher-income individuals. Individuals with modified adjusted gross income (AGI) between \$125,000 and \$145,000 (\$250,000 and \$290,000 for married couples filing jointly) must repay a portion of the subsidy. If a taxpayer's modified AGI exceeds \$145,000 (\$290,000 for married couples filing jointly) the full amount of the subsidy must be repaid as an additional tax. A higher-income individual can elect to waive COBRA premium assistance.*

COMMENT. *The House bill also allows the IRS to disclose return information to the U.S. Department of Health and Human Services (HHS) to enhance the integrity of the Medicare program.*

INFRASTRUCTURE INCENTIVES

The House bill extends and modifies a number of temporary infrastructure incentives.

Bonds

The House bill includes a variety of enhancements to the Build America Bonds program. The bill would also exclude water and sewage exempt-facility bonds from state volume caps and bonds financing facilities that furnish water and sewage facilities from limitations on tribal government issuances. Additionally, the bill excludes certain categories of private activity bonds from the alternative minimum tax (AMT) if issued in 2011 and to refunding of private activity bonds issued after 2003 and refunded during 2011. The bill also extends

and makes an additional allocation of Recovery Zone bonds.

COMMENT. *The American Recovery and Reinvestment Act of 2009 (2009 Recovery Act) included similar provisions applicable to private activity bonds issued in 2009 or 2010 and to refunding of private activity bonds issued after 2003 and refunded during 2009 and 2010.*

New Markets Tax Credit

The New Markets Tax Credit program grants a 39-percent total federal tax credit over the course of seven years to taxpayers who make qualifying investments in a community development entity. The House bill allows the New Markets Tax Credit to be claimed against the alternative minimum tax (AMT) with respect to qualified investments made on or after March 15, 2010 and on or before December 31, 2010.

IMPACT. *The American Recovery and Reinvestment Act of 2009 allocated a maximum of \$5 billion for the credit for 2008 and 2009*

Low Income Housing Credit

The American Recovery and Reinvestment Act of 2009 allowed state housing credit agencies to directly receive a payment for low-income housing in lieu of low-income housing credit allocations for 2009. The House bill extends this treatment for allocations for 2010.

Federal Home Loan Banks

The House bill extends tax-exempt eligibility for loans guaranteed by Federal Home Loan Banks.

Small Issuer Rules

The House bill extends temporary small issuer rules for allocation of tax-exempt interest expense. These rules would now sunset on December 31, 2011.

INTERNATIONAL TAX REFORMS

The House extenders bill includes a number of international tax reform measures. Some of the measures reflect proposals by the Obama administration; others build on measures previously introduced in the House.

***COMMENT.** The House bill does not include a controversial international entity-classification reform proposed by the Obama administration in its FY 2010 federal budget. The White House had called for repeal of the “check-the-box” rules. The administration dropped this recommendation in its FY 2011 federal budget.*

Foreign Tax Credit Reforms

The Obama administration is concerned about abuses involving the foreign tax credit, which is designed to prevent double taxation of foreign income. Corporations have devised techniques that keep the foreign income untaxed in the U.S., while foreign taxes are used to offset U.S. tax due on other foreign-source income. Often the foreign income is permanently reinvested offshore and never taxed in the U.S.

The House bill adopts a matching rule to prevent the separation of creditable foreign taxes from the associated foreign income. The bill would suspend the recognition of foreign tax credits until the related foreign income is taxed in the U.S.

***IMPACT.** These foreign tax credit reforms would prevent inappropriate separation of creditable foreign taxes in cases such as hybrid arrangements.*

***IMPACT.** The rules to prevent splitting foreign tax credits from the income to which they relate will apply to foreign income taxes paid or accrued after May 20, 2010 and to foreign income taxes paid or accrued by a foreign corporation on or before May 20, 2010 and not deemed paid under Code Sec. 902(a) or 960.*

Asset acquisitions. If a stock acquisition is treated as an asset acquisition, the assets ac-

quired obtain a stepped-up basis. For a foreign entity, this step-up exists only for U.S. taxes, not foreign taxes. The House bill prevents taxpayers from claiming the foreign tax credit on foreign income that is never taxed in the U.S. under this scenario.

Treaties and interest expense. The foreign tax credit is limited to the maximum U.S. tax rate (35 percent) on foreign-source income. According to the Obama administration, taxpayers are using treaties to inflate foreign source income by shifting the source of certain assets (for example, U.S. securities) to foreign branches and disregarded entities. The House bill segregates the income so that it is not used for claiming foreign tax credits. The bill would also ensure that foreign source interest expense is taken into account when determining the foreign tax credit limitation.

Section 956. Code Sec. 956 recharacterizes income from the sale of property as a dividend. The House bill would limit the foreign tax credits claimed on a deemed dividend under Code Sec. 956 to the amount that would have been allowed on an actual dividend.

Redemptions

If a foreign parent company owns a U.S. company, which in turn owns a foreign subsidiary, the latter's earnings are taxed in the U.S. when distributed to the U.S. shareholder. If the foreign parent sells stock in the U.S. company to its foreign subsidiary, the parent can recharacterize the gain as a dividend, which allows the foreign subsidiary's earnings to bypass U.S. taxes. The House bill requires the subsidiary's earnings to remain subject to U.S. tax when repatriated to the foreign parent as a dividend.

80/20 Rules

Dividends and interest paid by a U.S. corporation to a foreign payee may be excluded from U.S. withholding tax if at least 80 percent of the U.S. corporation's gross income is foreign source during a three-year test period and is attributable to the active conduct of a foreign trade or business. The House tax extenders bill

What's Next for Tax Legislation

The Extenders Act represents the third piece of major tax legislation expected to clear Congress in 2010. The Hiring Incentives to Restore Employment (HIRE) Act (P.L. 111-147) and the Health Care Reform Package (P.L. 111-148 and P.L. 111-152) have already made hundreds of changes to the Internal Revenue Code. Nevertheless, Congress is not finished, with a “must-do” tax list left for 2010 that includes:

- Addressing the levels at which income tax rates should be set for 2011 and beyond, with higher rates anticipated from upper bracket taxpayers;
- Reinstating the federal estate tax, at levels yet to be determined; and
- Extending an alternative minimum tax (AMT) patch for 2010 to protect many middle-income taxpayers

On the short list of popular tax proposals that have already been introduced in Congress in 2010 are:

- Additional small business tax relief, including a 100 percent gain exclusion on qualified small business stock and an enhanced start-up expense deduction, as passed by the House in the Small Business and Infrastructure Jobs Tax Act of 2010 (H.R. 4849); and
- A host of individual relief measures passed by the House in the Taxpayer Assistance Act of 2010 (H.R. 4994), including relaxed cell phone substantiation and improved offers in compromise (OIC) procedures.

would repeal the 80/20 company rules and also repeal the 80/20 rules for interest paid by resident alien individuals effective for tax years beginning after December 31, 2010.

Source Rules on Guarantees

Under the House bill, guarantees would be sourced like interest and if paid by U.S. taxpayers to foreign persons generally would be sub-

ject to withholding tax. This treatment would be effective for guarantees issued after the date of enactment.

COMMENT. This provision reverses the Tax Court's ruling in Container Corp., 134 T.C. No. 5, CCH Dec. 58,131, which treated guarantee fees as services.

HIRE Act Disclosures

The Hiring Incentives to Restore Employment (HIRE) Act included a package of foreign account compliance rules. The House bill clarifies when the limitations period will be tolled for corporations failing to provide requisite information on cross-border transactions or foreign assets. If failure to provide the required information is due to reasonable cause and not willful neglect, the limitations period would not be tolled.

CARRIED INTEREST REVENUE RAISER

A partnership does not pay income tax. Rather, income or loss flows through to the partners who include these items on their individual income tax returns. Certain partners may receive an interest in future profits in exchange for services, which is known as a "carried interest." Under current law, this income is generally taxed at capital gains rates.

Under the House bill's phase-in provision, 50 percent of the amounts paid on the carried interests of individual partners initially would be taxed as ordinary income. This treatment also applies to gain on the sale or exchange of a carried interest. While this treatment initially was to start immediately for tax years ending after the bill's date of enactment, the final House bill modified the effective date to garner votes. The carried interest tax rate would not change until January 1, 2011.

IMPACT. The House bill does not exempt any industries, such as commercial real estate, from the change in taxation of carried interest. Venture capital firms in particular have been lobbying hard for some carve

outs. While the House bill itself represents a compromise in light of opposition to the sweeping effect of the carried interest provision, further fine tuning may take place in the Senate before a new "extenders" law is finally sent to President Obama.

IMPACT. Managers of investment companies generally are paid in the neighborhood of two percent of fund assets as an annual management fee. Additionally, they may receive 20 percent of the profits above certain levels. Under current law, this 20 percent carried interest is taxed at a lower 15 percent capital gains rate rather than at ordinary income tax rates.

COMMENT. Under current law, the top individual marginal income tax rate of 35 percent is scheduled to rise to 39.6 percent after December 31, 2010.

IMPACT. Some investment companies have warned that the change will preclude them from offering attractive incentive opportunities for key personnel.

COMMENT. The ordinary income would be subject to self-employment tax.

COMMENT. Securities include stock, debt, derivatives, a hedge on securities, and other financial instruments.

OTHER REVENUE RAISERS

Employment Taxes

The House bill targets what some lawmakers view as employment tax evasion by certain service professionals who route their earnings through an S corp, limited partnership, or other entity while claiming a nominal salary. The bill specifically addresses the avoidance of employment taxes in situations where an S corp is engaged in a professional service business that is principally based on the reputation and skill of three or fewer individuals or the S corporation is a partner in a professional service business. The bill adds additional rules to curb these abuses for tax years beginning after December 31, 2010.

Dividends Received in Reorganization Exchanges

A limitation on recognition of gain for certain qualified corporate reorganizations can result in distributions of property with minimal U.S. tax consequences, according to the Obama administration. The House bill repeals this limitation in reorganization transactions in which the acquiring corporation is either domestic or foreign and the shareholder's exchange has the effect of the distribution of a dividend within the meaning of Code Sec. 356(a)(2).

COMMENT. The House bill clarifies that the Secretary of the Treasury has the flexibility of adding to the types of reorganizations in which earnings and profits of the parties to the reorganization are taken into account in determining dividend treatment.

Reverse Morris Trust Transactions

The House bill targets abuses in so-called "Reverse Morris Trust" transactions. Under a Reverse Morris Trust, a parent company spins-off a subsidiary, which merges into an unrelated company tax-free when the shareholders of the parent company control more than 50 percent of the voting rights and economic capital of the resulting merged company.

IMPACT. The Reverse Morris Trust has been criticized as providing a tax loophole for companies wanting to sell unwanted assets.

Oil Spill Liability Trust Fund

The House bill would raise the federal oil spill recovery trust fund excise tax to 34 cents per barrel through December 31, 2020. The bill also removes single incident expenditure caps from the Oil Spill Liability Trust Fund.

Corporate Estimated Tax

The House bill increases corporate estimated tax payments for large corporations due in July, August and September 2015 by 36 percentage points.

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