LOEB & LOEB LLP

Tax Law

JANUARY 2016

Congress Extends Various Tax Benefits

There has been a long history of various tax benefits being extended for short periods. In many recent years, Congress has enacted provisions late in the year, often in December, to extend various provisions for another year, sometimes retroactively for the year about to end. This year, Congress again extended certain provisions but, in a break from its tradition, finally made permanent certain provisions and extended others for several years. The provisions were primarily contained in a portion of the Consolidated Appropriations Act, 2016 (P.L. 114-113) (the "Act"). The list of tax benefits affected is extensive and the actual legislation covers more than 200 printed pages. Below we summarize a few of the extended provisions that we believe are most important to our readers.

INDIVIDUAL TAXPAYERS

IRA Charitable Rollover. Congress finally made permanent the ability to transfer up to $100,000 per year from an Individual Retirement Account directly to a charity. While the taxpayer does not receive a charitable contribution deduction for such transfer, the taxpayer does not have to include the transferred amount in taxable income, even though the transferred amount counts against the required minimum distribution the taxpayer is otherwise required to take that year. The charitable rollover can be especially beneficial in a year when the individual would be subject to alternative minimum tax, which reduces the value of a charitable contribution deduction.

Election to Deduct State and Local Sales Taxes in Lieu of Income Taxes. The election to forgo an itemized deduction for state and local income tax and instead claim a deduction for the amount of state and local sales tax paid has also been made permanent. This election can be beneficial for taxpayers whose income is primarily from sources that are exempt from state or local income tax (e.g., interest on government bonds).

BUSINESS TAXPAYERS

Basis Adjustment Provision for S Corporation Making Charitable Contribution of Property. When an S corporation makes a contribution of an appreciated capital asset, a deduction equal to the value of the property can be passed to the shareholders of the corporation. However, because the appreciation in the value of the asset is not realized as taxable income, the shareholders' tax basis in their shares does not reflect such appreciation amount. In some cases, this may result in the shareholders not having sufficient tax basis to utilize the full amount of the deduction. A provision that Congress has periodically renewed provides that when an appreciated capital asset is donated by an

S corporation, the shareholders have to reduce the tax basis of their shares only by the amount of the S corporation's tax basis of the donated asset, rather than by its fair market value. The last extension of this provision expired on December 31, 2014. This provision has now been made a permanent part of the Internal Revenue Code ("Code") retroactive to January 1, 2015.

Reduction of Built-In Gain Period for S Corporations to Five Years. An S corporation that previously was a C corporation is required to pay tax on certain dispositions of assets that were appreciated in the hands of the C corporation at the time the election of S corporation status became effective. Originally, the requirement to pay the corporate tax applied for the first ten years the corporation was an S corporation. The ten-year period was temporarily shortened to seven years for tax years beginning in 2009 or 2010. Beginning in 2011, the period was further reduced to five years for tax years through 2014. The period would have reverted to ten years in 2015; however, the Act has now made permanent the five-year period. The effect of the new law is that if a corporation's first year as an S corporation was 2010 and the corporation sold an asset in 2015 that was appreciated on January 1, 2010, the corporate tax does not apply because five tax years have passed before 2015. During 2016, a corporation that has been an S corporation since 2011 can sell assets free of any corporate level tax.

Increased Expensing Limits for Depreciable Property. Section 179 of the Code permitted taxpayers to elect to take a deduction up to $25,000 per year for the cost of certain qualifying property placed in service in a business that would otherwise be subject to depreciation over a period of years. Beginning in 2003, a series of provisions temporarily increased this amount. For tax years from 2010 through 2014, the amount that could be expensed was $500,000 per year, subject to being phased out on a dollar-for-dollar basis if the taxpayer placed more than $2,000,000 of such property in service during the tax year. In 2015, the limit was scheduled to return to $25,000; however, the $500,000 deduction amount was made permanent retroactive to January 1, 2015. The deduction is still subject to being phased out if the taxpayer puts in service more than $2,000,000 of depreciable property during the year. After 2015, both the $500,000 amount and the $2,000,000 amount will be indexed for inflation.

Exclusion of 100% of Gain Recognized on Certain Small Business Stock. Section 1202 of the Code allows taxpayers to exclude 50% of the gain recognized from the sale of certain small business stock. The stock must be acquired on original issuance by a C corporation, the taxpayer must hold it for at least five years and the corporation must engage in an active business and cannot have gross assets of more than $50,000,000 when the taxpayer acquires his stock. The amount of excluded gain is limited to the greater of $10,000,000 or ten times the taxpayer's basis in the stock. For stock acquired after February 17, 2009, and before September 28, 2010, the exclusion was increased to 75% of the gain, and for stock acquired after September 27, 2010, and before January 1, 2015, it was further increased to 100%. The 100% exclusion has now been made permanent for all stock acquired after December 31, 2014. The excluded gain is also no longer a tax preference item for alternative minimum tax purposes.

New Markets Tax Credit Extended Through 2019. A new markets tax credit has been available for

investment in stock or a partnership interest in an entity that is a qualified Community Development Entity ("CDE"). A qualified CDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons; (2) that maintains accountability to residents of low-income communities by their representation on any governing board of or any advisory board to the CDE; and (3) that is certified by the Secretary of the Treasury as being a qualified CDE. The credit was 5% of the amount of equity interest purchased in the CDE for the year of purchase and the following two years, and then 6% per year for the following four years. The current credit expired at the end of 2014.

The Act extends the credit for five more years through 2019 and extends the period to which unused credits may be carried through 2024. The maximum annual amount of qualified equity investments will remain at $3.5 billion for each of the five additional years of the credit.

Bonus First Year Depreciation Extended. Prior to 2015, a taxpayer was allowed to claim 50% of the cost of certain qualified new property placed in service as additional depreciation in the first year of such service. The Act has extended this bonus depreciation through 2019; however, in 2018 the percentage is reduced to 40% and in 2019 to 30%. In order to qualify for this bonus depreciation, the property must be: (1) property to which the modified accelerated cost recovery system ("MACRS") applies with an applicable recovery period of 20 years or less; (2) water utility property; (3) computer software other than computer software covered by Section 197 of the Code; or (4) qualified leasehold improvement property. In addition, the original use of the property must commence with the taxpayer.

Film and Television Expensing Provision Extended and Expanded. Prior to 2015, a taxpayer could deduct up to $15,000,000 per year of costs incurred in connection with the production of qualified television programming or motion picture films. If the amounts were expended in low income communities, the annual limit was increased to $20,000,000. This deduction expired on December 31, 2014; however, the Act extended the deduction for two more years through 2016. The deduction was also expanded to include any qualified live theatrical productions commencing after December 31, 2015. A live theatrical production commences for this purpose on the date of the first public performance of the production that is attended by a paying audience. A qualified live theatrical production is defined as a live staged production of a play (with or without music) that is derived from a written book or script and is produced or presented by a commercial entity in any venue that has an audience capacity of not more than 3,000, or a series of venues the majority of which have an audience capacity of not more than 3,000. In addition, qualified live theatrical productions include any live staged production that is produced or presented by a taxable entity no more than ten weeks annually in any venue with an audience capacity of not more than 6,500. In general, in the case of multiple live staged productions, each such live staged production is treated as a separate production.

ENERGY CREDITS

Congress extended the 30% energy Investment Tax Credit ("ITC") for qualified solar energy property and the production tax credit for qualified wind facilities.

The extension not only provides certainty with respect to the law, but also will continue the growth in clean energy projects to create jobs and reduce pollution.

The solar energy ITC, which was scheduled to be reduced to 10% for property placed in service after December 31, 2016, will continue at 30% through 2019, before being phased down as follows: 26% ITC in 2020, 24% ITC in 2021, 22% ITC in 2022 and 10% ITC thereafter. Moreover, the percentage will be based on the year in which construction of the project begins, rather than the year in which the property is placed in service.

The production tax credit for qualified wind facilities had technically expired unless construction had begun before January 1, 2015. The Act retroactively extends the credit for any qualified wind facility where construction begins before January 1, 2020. However, the credit is phased out for facilities where construction begins after December 31, 2016. The credit is reduced by 20% if construction begins in 2017, 40% in 2018 and 60% in 2019.

The Act also retains provisions allowing taxpayers to elect to convert a wind facility production tax credit into an energy ITC, subject to the phase-outs.

REAL ESTATE PROVISIONS

REITS. A REIT is a tax-advantaged vehicle for investing in real property and mortgages on real property. Assuming its many requirements are met, the REIT generally is not taxed on its income that is distributed to its investors, and the character of the REIT's income as qualified dividends or as capital gain may be preserved for the investors.

The Act eliminates the ability of a real estate rich corporation to separate tax-free into an operating company and a property company REIT. Under the Act, a spin-off will be taxable if either (but not both) the distributing corporation or the controlled corporation is a REIT immediately after the distribution. The Act also prohibits either corporation from electing to be taxable as a REIT for ten years after the distribution.

The Act reduces the percentage of the value of a REIT's assets that may be represented by securities in a taxable REIT subsidiary (TRS) from 25% to 20% for taxable years beginning after 2017.

For taxable years beginning after 2014, the Act retroactively repeals the prohibition on preferential dividend distributions for publicly offered REITs (i.e., a REIT that is required to file annual and periodic reports to the SEC under the Securities Exchange Act of 1934), but limits a REIT's ability to designate distributions as qualified dividends or capital gain dividends to the dividends actually paid by the REIT with respect to the taxable year.

Debt instruments issued by publicly offered REITs are now qualified assets, and the income therefrom which would not otherwise constitute qualified income is qualified income for purposes of the 95% income test. However, such debt instruments may not exceed 25% of the value of the REIT's assets.

The Act also clarifies the treatment of ancillary personal property that is leased with real property for purposes of the asset and income tests; allows the IRS to provide alternative remedies for inadvertent preferential dividend distributions by non-publicly offered REITs; expands the services permitted to be provided by a TRS, but imposes a 100% excise tax on non-arm's length transactions with a TRS; expands the ability of a REIT to engage in certain hedging transactions and to avoid certain prohibited

transactions; and modifies the method for computing earnings and profits to eliminate duplicate taxation.

FIRPTA Provisions. Generally, foreign persons are not subject to U.S. federal income tax on U.S.-sourced capital gain, unless the capital gain is effectively connected with a trade or business in the United States or is realized by an individual who is present in the United States for at least 183 days during the taxable year. For this purpose, gain from the disposition of a U.S. real property interest (USRPI), including stock in a U.S. real property holding corporation, is treated as being effectively connected with a U.S. trade or business. Similarly, with certain exceptions, built-in gain is recognized upon a foreign corporation's distribution of a USRPI to a shareholder. The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) requires certain reporting of and withholding on dispositions of USRPIs by foreign persons. The Act modifies the rules to encourage greater foreign investment in U.S. real property.

The Act increases from 5% to 10% the amount of REIT stock a shareholder may own in a class of publicly traded stock without such stock being treated as a USRPI. The Act similarly increases from 5% to 10% the ownership threshold for treating distributions to holders of publicly traded REIT stock attributable to gains from dispositions of USRPIs as a dividend rather than as FIRPTA gain. In addition, REIT stock held by a qualified foreign shareholder who owns not more than 10% of the class of REIT stock (whether directly or indirectly through a partnership) is excluded.

The Act also excludes from FIRPTA USRPIs held (directly or indirectly through a partnership) by qualified foreign pension funds (or by a foreign entity wholly owned by a qualified foreign pension fund). A qualified foreign pension fund is a trust, corporation or other organization or arrangement (a) that is created or organized under the law of a foreign country, (b) that is established to provide retirement or pension benefits to participants or beneficiaries that are current or former employees in consideration for services, (c) that does not have a single participant or beneficiary with a right to more than 5% of its assets or income, (d) that is subject to government regulation and provides for annual information reporting about its beneficiaries to the relevant tax authorities in the country in which it is established or operates, and (e) with respect to which, under the laws of the country in which it is established or operates, (i) contributions to such organization or arrangement that would otherwise be subject to tax under such laws are deductible or excluded from the gross income of such entity or taxed at a reduced rate, or (ii) taxation of any investment income of such organization or arrangement is deferred or such income is taxed at a reduced rate.

On the flip side, the Act increases the required withholding from 10% to 15% of the gross purchase price or distribution of the USRPI, prevents stock in a REIT from ever ceasing to be a USRPI under the five-year cleansing rule, and prohibits dividends from a REIT from being treated by a foreign owner as a dividend from a U.S. corporation for purposes of the dividends received deduction.

Depreciation Provisions. The Act retroactively makes permanent 15 year MACRS depreciation for qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property (collectively, qualified real property).

We noted above that the Act also retroactively made permanent the ability to expense qualifying property, including qualified real property, up to $500,000, subject to adjustments noted. The previous exclusion from this provision of air conditioning and heating units is eliminated for taxable years beginning after 2015.

In addition, the Act retroactively extends 50% bonus depreciation for qualified leasehold improvement property placed in service before January 1, 2019, at 40% if placed in service in 2019 and at 30% if placed in service in 2020. A corporation's ability to forgo bonus depreciation on such property and increase its alternative minimum tax credit is also extended.

Loeb & Loeb's Tax Practice

MICHELLE W. ALBRECHT	MALBRECHT@LOEB.COM	212.407.4181
JOHN ARAO	JARAO@LOEB.COM	310.282.2231
MARLA ASPINWALL	MASPINWALL@LOEB.COM	310.282.2377
RYAN M. AUSTIN	RAUSTIN@LOEB.COM	310.282.2268
SASHA M. BASS	SBASS@LOEB.COM	310.282.2053
LAURA B. BERGER	LBERGER@LOEB.COM	310.282.2274
LEAH M. BISHOP	LBISHOP@LOEB.COM	310.282.2353
SUSAN G. BLUMENTHAL	SBLUMENTHAL@LOEB.COM	202.618.5009
DEBORAH J. BROSS	DBROSS@LOEB.COM	310.282.2245
TARIN G. BROSS	TBROSS@LOEB.COM	310.282.2267
CHRISTOPHER W. CAMPBELL	CWCAMPBELL@LOEB.COM	310.282.2321
THERESA R. CLARDY	TCLARDY@LOEB.COM	310.282.2058
REGINA I. COVITT	RCOVITT@LOEB.COM	310.282.2344
TERENCE F. CUFF	TCUFF@LOEB.COM	310.282.2181
LINDA N. DEITCH	LDEITCH@LOEB.COM	310.282.2296
PAUL N. FRIMMER	PFRIMMER@LOEB.COM	310.282.2383
ANDREW S. GARB	AGARB@LOEB.COM	310.282.2302
ELIOT P. GREEN	EGREEN@LOEB.COM	212.407.4908
RACHEL J. HARRIS	RHARRIS@LOEB.COM	310.282.2175
TANYA A. HARVEY	THARVEY@LOEB.COM	202.618.5024
DAVID M. HODGE	DHODGE@LOEB.COM	310.282.2224
DIARA M. HOLMES	DHOLMES@LOEB.COM	202.618.5012
AMY L. KOCH	AKOCH@LOEB.COM	310.282.2170
KAREN L. KUSHKIN	KKUSHKIN@LOEB.COM	212.407.4984
THOMAS N. LAWSON	TLAWSON@LOEB.COM	310.282.2289
ALEXANDRA A. LETZEL	ALETZEL@LOEB.COM	310.282.2178
JEROME L. LEVINE	JLEVINE@LOEB.COM	212.407.4950
JASON R. LILIEN	JLILIEN@LOEB.COM	212.407.4911
JEFFREY M. LOEB	JLOEB@LOEB.COM	310.282.2266
MARY ANN MANCINI	MMANCINI@LOEB.COM	202.618.5006
ANNETTE MEYERSON	AMEYERSON@LOEB.COM	310.282.2156
DAVID C. NELSON	DNELSON@LOEB.COM	310.282.2346
STEVEN M. OLENICK	SOLENICK@LOEB.COM	212.407.4854
LANNY A. OPPENHEIM	LOPPENHEIM@LOEB.COM	212.407.4115
MARCUS S. OWENS	MOWENS@LOEB.COM	202.618.5014
RONALD C. PEARSON	RPEARSON@LOEB.COM	310.282.2230
ALYSE N. PELAVIN	APELAVIN@LOEB.COM	310.282.2298
JONATHAN J. RIKOON	JRIKOON@LOEB.COM	212.407.4844
TZIPPORAH R. ROSENBLATT	TROSENBLATT@LOEB.COM	212.407.4096
BRANDON A.S. ROSS	BROSS@LOEB.COM	202.618.5026
STANFORD K. RUBIN	SRUBIN@LOEB.COM	310.282.2090
LAURIE S. RUCKEL	LRUCKEL@LOEB.COM	212.407.4836
CRISTINE M. SAPERS	CSAPERS@LOEB.COM	212.407.4262
JOHN F. SETTINERI	JSETTINERI@LOEB.COM	212.407.4851
MEGAN A. STOMBOCK	MSTOMBOCK@LOEB.COM	212.407.4226
JENNIFER TAM	JTAM@LOEB.COM	202.618.5023
ALAN J. TARR	ATARR@LOEB.COM	212.407.4900
STUART P. TOBISMAN	STOBISMAN@LOEB.COM	310.282.2323
JESSICA C. VAIL	JVAIL@LOEB.COM	310.282.2132
GABRIELLE A. VIDAL	GVIDAL@LOEB.COM	310.282.2362
BRUCE J. WEXLER	BWEXLER@LOEB.COM	212.407.4081
DANIEL M. YARMISH	DYARMISH@LOEB.COM	212.407.4116