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CERTIFIED PUBLIC ACCOUNTANTS

TAX ALERT

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Spending bill extends tax breaks, adds retirement account provisions

In late December 2019, the President signed into law the Further Consolidated Appropriations Act, 2020 ("FCAA"). The legislation extends certain income tax provisions that had expired, as well as some that were due to expire at the end of 2019.

Congress traditionally passes so-called "extenders" annually, but it neglected to do so for 2018. As a result, several popular breaks for both individuals and businesses expired at the end of 2017.

The FCAA also includes the Setting Every Community Up for Retirement Enhancement Act ("SECURE Act"). The SECURE Act is the first significant retirement-related legislation since the Pension Protection Act of 2006.

In addition, the FCAA includes the Taxpayer Certainty and Disaster Tax Relief Act of 2019 ("Disaster Relief Act"), which specifically contain provisions that impact certain tax-exempt organizations.

The FCAA will likely have substantial repercussions for tax, retirement, estate planning, and disaster tax relief.

Overview of Extended Tax Breaks

The new legislation extends the following tax provisions, among others, through 2020; some of these were established on a temporary basis by the Tax Cuts and Jobs Act (TCJA):

1: Exclusion of discharge of mortgage debt. Homeowners who have undergone foreclosure, a short sale, a loan modification, or otherwise had mortgage debt forgiven, can exclude up to $2 million of the debt from their gross income ($1 million for married individuals filing separately).

The debt generally must have resulted from the acquisition, construction or substantial improvement of their principal residence. The law also modifies the exclusion to make it apply to debt discharged under a binding written agreement entered into before January 1, 2021.

2: Deduction for mortgage insurance premiums. Homeowners can now continue to treat their qualified mortgage insurance premiums as deductible mortgage interest — assuming they itemize their deductions. The deduction begins to phase out when adjusted gross income (AGI) exceeds $100,000 ($50,000 if married filing separately). This deduction had expired at the end of 2017

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and has been extended through 2020.

3: Deduction for unreimbursed medical expenses. The TCJA reduced the threshold for deducting unreimbursed medical expenses from 10% to 7.5% of AGI for 2017 and 2018. The lower threshold has now been extended through 2020. Qualified medical expenses in excess of the threshold can be claimed as an itemized deduction.

4: Deduction for qualified tuition and related expenses. The above-the-line deduction for higher education expenses reduces a taxpayer's AGI and is available regardless of whether the taxpayer itemizes (though it generally can't be taken if certain tax credits for education expenses are claimed). The deduction is limited to $4,000 for individual taxpayers whose AGI doesn't exceed $65,000 ($130,000 for joint filers) or $2,000 for individuals whose AGI doesn't exceed $80,000 ($160,000 for joint filers). This deduction had expired at the end of 2017.

5: Incentives for empowerment zones. The law extends the incentives — including tax-exempt bonds, employment credits, increased expensing on qualifying equipment, and capital gains deferral on the sale of qualified assets sold and replaced — for eligible businesses and employers to operate in the 41 specifically designated economically distressed areas.

6: New Markets Tax Credit (NMTC). Businesses can earn NMTCs for investments in real estate projects, community facilities, and operating businesses in low-income communities. The credit generally equals 39% of the original investment amount, claimed over a period of seven years beginning on the date of the investment.

The new law provides a $5 billion allocation for the credit for 2020 and extends for one year, through 2025, the carryover period for unused credits. In certain circumstances, the NMTC can enhance the tax benefits of investing in empowerment zones.

7: Employer tax credit for paid family and medical leave. The TCJA created a new tax credit for certain employers that provide paid family and medical leave but made it available only for 2018 and 2019. Eligible employers can now claim the credit through 2020 if they have a written policy providing at least two weeks of such leave annually to all qualifying employees (both full- and part-time) and meet certain other requirements.

The amount of the credit begins at 12.5% of wages paid if the leave payment rate is at least 50% of the normal wage rate. The percentage rises incrementally by 0.25 percentage points as the rate of leave payment exceeds 50%, with a maximum credit of 25% when full wages are paid for the leave.

The maximum amount of family and medical leave that may be taken into account with respect to any qualifying employee is 12 weeks per tax year.

8: Work Opportunity Tax Credit (WOTC). The WOTC was due to expire at the end of 2019. It's available to employers that hire individuals who are members of 10 targeted groups, including certain qualified veterans, ex-felons, and individuals receiving state benefits. Employers that hire such employees can claim the tax credit as a general business credit against their income tax.

9: Energy Efficient Homes Credit. The law provides a credit for manufacturers of energy-efficient residential homes. An eligible contractor may claim a tax credit of $1,000 or $2,000 for the construction or manufacture of a new energy efficient home that meets qualifying criteria. The new law extends the credit for energy-efficient new homes to homes acquired before January 1, 2021.

10: Energy Efficient Commercial Buildings Deduction. The Code provides a deduction for energy efficiency improvements to lighting, heating, cooling, ventilation, and hot water systems of commercial buildings. This includes a $1.80 deduction per square foot for construction on qualified property. A partial $0.60 deduction per square foot is allowed if certain subsystems meet energy standards but the entire building does not, including the interior lighting systems, the heating, cooling, ventilation, and hot water systems, and the building envelope. The new law extends these deductions to property placed into service before January 1, 2021.

Changes to Retirement Plans

The SECURE Act is packed with more than two dozen provisions primarily intended to encourage saving for retirement, most of which take effect January 1, 2020. They include measures affecting both individuals and businesses.

Impact on Individuals

1: Repeal of the maximum age for IRA contributions. The SECURE Act eliminates the age restriction of 70 ½ so that anyone can contribute as long as they're working, matching the existing rules for 401(k) plans and Roth IRAs.

2: Increased the required minimum distribution age. The SECURE Act raises the age at which taxpayers generally must begin to take their required minimum distributions (RMDs) from 70½ to 72. The new rule applies only to those individuals who haven't reached the age of 70½ by the end of 2019.

3: Penalty-free withdrawals for child birth or adoption. The law also includes a new exemption from the 10% tax penalty on early withdrawals from retirement accounts. Taxpayers can withdraw an aggregate of $5,000 from a plan without penalty within one year of the birth of a child or an adoption becoming final.

4: Elimination of "Stretch" RMDs. Less favorably for individual taxpayers, the SECURE Act eliminates the "stretch" RMD provisions that have permitted beneficiaries of inherited retirement accounts to spread the distributions over their life expectancies.

Now, most nonspouse beneficiaries must take their distributions over a 10-year period beginning the year of the deceased's death. That could increase the tax burden by pushing the distributions into years when the beneficiary is working and in higher tax brackets. The change, therefore, could require some modifications to estate plans, particularly if the plans include trustee-

managed inherited IRAs with guardrails to prevent young beneficiaries from quickly draining the accounts.

California Conformity. In general, California automatically conforms to changes to the provisions affecting the qualifications for retirement plans. California however does not automatically conform to provisions that address whether contributions are tax deductible or distributions are tax-exempt. In view of this, unless California enacts conforming legislation, the state will not allow individuals age 70 ½ or older to made deductible contributions to a traditional IRA.

Impact on Businesses

5: Open MEP Provisions. The SECURE Act expands access to open multiple employer plans (MEPs). MEPs give smaller, unrelated businesses the opportunity to team up to provide defined contribution plans at a lower cost, due to economies of scale, with looser fiduciary duties. It also provides tax credits to employers for starting retirement plans and automatically enrolling employees.

6: Annuity Safe Harbor Provisions. The new law paves the way for employers to include annuities in their retirement plans by eliminating their potential liability when it comes to selecting the appropriate annuity plans.

7: Plan Contributions for Part-Time Workers. The SECURE Act requires employers to allow participation in their retirement plans by part-time employees who have worked at least 1,000 hours in one year or three consecutive years of at least 500 hours.

Provisions Impacting Tax-Exempt Organizations and Charitable Giving

The Disaster Relief Act provides tax relief to donors who would like to help victims of natural disasters, including those affected by California's recent forest fires.

Following are provisions of this Act that impact tax-exempt organizations.

1: Temporary suspension of limitations on charitable contributions. The Disaster Relief Act temporarily suspends the charitable deduction limitations for charitable donations associated with qualified disaster relief. This special treatment applies to contributions made in 2018 and 2019, as well as contributions made within 60 days after passage of the Act (December 20, 2019). Donors will be able to deduct the full amount of these contributions, even if the contribution amount exceeds the 60% adjusted gross income limitation for individuals or the 10% taxable income limitation for corporations. In order to claim the full deduction, donors must obtain acknowledgement from the charity that the donation was used or will be used for disaster relief purposes.

2: Special rules for qualified disaster-related personal casualty losses. With respect to uncompensated losses arising in a disaster area, the Disaster Relief Act eliminates the current law requirements that personal casualty losses must exceed 10% of adjusted gross income to qualify for deduction. The Disaster Act also eliminates the current law requirement that taxpayers must itemize deductions to access this tax relief.

3: Special disaster-related rules for use of retirement funds. The Disaster Relief Act provides an exception to the 10% early retirement plan withdrawal penalty for qualified disaster relief distributions (not to exceed $100,000 in qualified hurricane distributions cumulatively). It allows for the re-contribution of retirement plan withdrawals for home purchases canceled due to eligible disasters, and provides flexibility for loans from retirement plans for qualified hurricane relief.

4: Employee retention credit for employers affected by qualified disasters. The Disaster Relief Act creates a "2018 through 2019 qualified disaster employee retention credit." The tax credit is for 40% percent of wages (up to $6,000 per employee) paid by a disaster-affected employer to an employee from a core disaster area during 2018 and 2019. The credit applies to wages paid without regard to whether services associated with those wages were performed. The credit is treated as a current year business credit under Code Sec. 38(b).

5: Special Rule for Determining Earned Income. The Disaster Relief Act allows taxpayers in designated disaster areas to refer to earned income from the immediately preceding year for purposes of determining the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC) in tax year 2018.

6: Modified excise tax. The Disaster Relief Act replaces the two-tiered excise tax rules for private foundations with a flat rate of 1.39%. This modification applies to tax years beginning after December 20, 2019 or 2020 for calendar year taxpayers.

7: Repeal of "parking tax." The Act also retroactively repeals IRS Section 512(a)(7), which imposed a 21% tax on tax-exempt organizations for their employees' parking and transit benefits. As such, tax-exempt organizations that paid the parking tax (on parking and transit benefits paid or incurred after December 31, 2017) may have federal and state refund claim opportunities. Tax-exempt organizations may claim a federal refund or credit attributable to the parking tax paid by filing an amended Form 990-T. Instructions and information is available at www.irs.gov/forms-pubs/how-to-claim-a-refund-or-credit-of-unrelated-business-income-tax-ubit-or-adjust-form-990-t-for-qualified-transportation-fringe-amounts. Organizations should check they state law before filing a state refund claim, as some states have not conformed to the repeal. Note that although the new law repealed the "parking tax", tax exempt organizations are still not allowed to deduct expenses of providing qualified transportation fringe benefits to its employees against unrelated business income when the deduction would otherwise be allowable were it directly connected with the carrying on of an unrelated trade or business.

Action Required

The extension of tax breaks that were thought to have expired at the end of 2017 when filing federal income tax returns for the 2018 tax year means that some taxpayers should consider filing amended returns for the year. Changes to the laws for retirement savings may require rethinking both your retirement and estate planning. Your Seiler tax advisor can help you chart the best course to reduce your taxes and maximize your and your heirs' financial cushions under current law.

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