Legislative Affairs Update

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Summary of Tax Provisions of the Job Creation and Worker Assistance Act of 2002

BUSINESS PROVISIONS

30 Percent First-Year Depreciation – The Act allows 30 percent additional first-year depreciation, for both regular tax and alternative minimum tax, for property placed in service after September 10, 2001, in taxable years **ending** after that date. To qualify for the additional first-year depreciation deduction the property must be: (1) property to which the general rules of MACRS apply with an applicable recovery period of 20 years or less (i.e., vehicles, computers, office equipment, etc.), (2) water utility property, (3) certain computer software, or (4) qualified leasehold improvement property. In addition, the property generally must be new property acquired after September 10, 2001 and before September 11, 2004.

Comment: The provision applies to 2001 calendar year filers. Taxpayers entitled to additional 30 percent depreciation for 2001 who have already filed will have to file amended returns. Guidance on how to claim the claim the additional 30 percent depreciation for 2001 will have to be issued immediately.

Five-Year Carryback of Net Operating Losses (NOL) – The Act temporarily extends the general NOL carryback period to five years (from two years, or three years in certain cases) for NOLs arising in taxable years ending in 2001 and 2002. The Act also allows an NOL arising in or carried forward to taxable years ending in 2001 and 2002, to offset 100 percent of a taxpayer's AMTI.

The five-year carryback provision is effective for NOLs generated in taxable years ending after December 31, 2000. The provision allowing the use of NOL carrybacks and carryforwards to offset 100 percent of AMTI is effective for taxable years ending before January 1, 2003.

TAX BENEFITS FOR NEW YORK CITY (NYC)

Expansion of Work Opportunity Tax Credit (WOTC) to Include Certain NYC Employment – The WOTC is available on an elective basis for employers hiring individuals from one or more of eight target groups. The maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages.

The Act creates a **new** targeted group for the WOTC. Generally, the new targeted group is individuals who perform substantially all their services in the recovery zone for a business located in a defined area of NYC referred to as the "New York Liberty Zone" ("Liberty Zone"). Unlike the other targeted categories, members of this targeted group will not require certification for their wages to qualify for the credit.

The provision is effective in taxable years ending after December 31, 2001 (for wages paid or incurred to qualified individuals for work after December 31, 2001 and before January 1, 2004).

<u>Special Depreciation Allowances for Certain NYC Property</u> – The Act allows an additional first-year depreciation deduction equal to 30 percent of the adjusted basis of qualified Liberty Zone property. The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service.

In general, this provision applies to real property which is **not** eligible for additional first-year depreciation under the "general" additional first-year depreciation rule described above. To qualify for the NYC 30 percent first-year depreciation, (1) substantially all of the use of such property must be in the Liberty Zone, (2) the original use of the property in the Liberty Zone must commence with the taxpayer on or after September 11, 2001, and (3) the property must be acquired by purchase by the taxpayer after September 10, 2001 and placed in service on or before December 31, 2006.

<u>Authorization of Tax Exempt Private Activity Bonds for Rebuilding NYC Property Damaged in September 11 Terrorist Attack</u> – The Act authorizes issuance during calendar years 2002, 2003, and 2004 of an aggregate amount of $8 billion of tax-exempt private activity bonds to finance the construction and rehabilitation of nonresidential real property and residential rental real property in the Liberty Zone. The Act also permits certain bonds for facilities located in NYC to be advance refunded one additional time.

<u>Increased Expensing and Extended Replacement Period for Liberty Zone Property</u> – The Act increases the maximum dollar amount that may be deducted under section 179 for qualifying Liberty Zone property by the lesser of (1) $35,000 or (2) the cost of qualifying property placed in service during the taxable year. This amount is in addition to the amount otherwise deductible under section 179.

The Act extends the section 1033 two-year period for a tax free replacement of involuntarily, converted property to five years for Liberty Zone property converted as a result of the September 11 terrorist attack.

The Act provides five-year depreciation lives for Liberty Zone leasehold improvements placed in service after September 10, 2001 and before January 1, 2007.

MISCELLANEOUS AND TECHNICAL PROVISIONS

Allow Form 1099 to be Furnished Electronically – The Act removes the statutory impediment to providing copies of specified information returns to taxpayers electronically. Accordingly, these copies may be furnished electronically to consenting recipients and copies may be furnished in a similar manner to Form W-2 or in another manner provided by the Secretary.

Discharge of S Corporation Indebtedness – The Act provides that income from the discharge of indebtedness of an S corporation that is excluded from the S corporation's income does **not** increase the basis of any shareholder's stock in the corporation (i.e., the Act reverses the Supreme Court decision in *Gitlitz v. Commissioner*). The provision applies generally to discharges after October 11, 2001.

Limitation on Use of Non-Accrual Experience Method of Accounting – The Act limits the use of the non-accrual experience method of accounting effective for taxable years ending after date of enactment. Any change in the taxpayer's method of accounting required as a result of the limitation is treated as a voluntary change initiated by the taxpayer with the consent of the Secretary. Any resultant section 481(a) adjustment is to be taken into account over a period not to exceed the lesser of the number of years the taxpayer has used the non-accrual experience method of accounting or four years under principles consistent with those in Rev. Proc. 99-49.

Expansion of the Exclusion for Foster Care Payments -- The Act expands the definition of qualified foster care payments (which are excludable) to include payments by any placement agency licensed or certified by a state or local government to make payments to providers of foster care. The Act also expands the definition of a qualified foster care individual by including foster care individuals placed by a qualified foster care placement agency regardless of the individual's age at the time of placement. These changes are effective for taxable years beginning after December 31, 2001.

Interest Rate Used in Determining Additional Required Contributions to Defined Benefit Plans – The Act expands the permissible range of the statutory interest rate used in calculating a plan's current liability for purposes of applying the additional contribution requirements for plan years beginning after December 31, 2001, and before January 1, 2004. The new permissible range is from 90 percent to 120 percent for these years (the old range was 90 percent to 105 percent).

Deduction for Classroom Materials – The Act provides an above-the-line deduction in 2002 and 2003 for up to $250 annually of expenses incurred by teachers, instructors, counselors, principals, etc. for books, supplies, computer equipment, and materials used in the classroom.

Technical Corrections and Clerical Amendments – The Act provides numerous technical corrections and clerical amendments to recently enacted tax provisions. Some of the more notable provisions are:

- Clarifications and transition rules for the 2001 adoption tax credit changes;
- Clarification to the 2001 pension-related amendments;
- An amendment to the 2000 kidnapped child rules clarifying that if a taxpayer met the household maintenance test for surviving spouse or head of household filing status, with respect to his or her child immediately before the kidnapping, then the taxpayer would be deemed to meet that requirement for purposes of the filing status rules until the child has reached age 18 or is determined to be dead; and
- An amendment to the 1997 rules providing for a reduced capital gain rate for assets acquired after 2000, clarifying that gain from the sale of a principal residence to which the mark-to-market election applies is included in income, notwithstanding that such gain would be excludable under section 121 if there had been an actual sale of the residence.

EXTENSIONS OF CERTAIN EXPIRING PROVISIONS

The Act provides the following extensions:

- The rule for 2000 and 2001 allowing individuals to use personal credits to offset both regular tax and alternative minimum tax liability is extended to 2002 and 2003.
- The phasedown in the credit for purchasing a qualified electric vehicle (previously scheduled for 2002-2004) is delayed two years, i.e., the phasedown will not commence until 2004.
- The credit for production of electricity from qualified wind closed-loop biomass or poultry waste facilities is extended two years so that it applies to facilities placed in service in 2002 or 2003.
- Both the welfare-to-work and the work-opportunity credits are extended two years so that they apply to wages paid to qualified employees hired in 2002 or 2003.
- The phasedown in the deduction for clean fuel vehicle property (scheduled to begin in 2002) is deferred two years.
- The suspension of the 100 percent of net income limit on percentage depletion is extended to taxable years beginning in 2002 and 2003.

- The Act authorizes issuance of up to $100 million of qualified zone academy bonds (bonds for certain elementary and secondary schools in empowerment zones) annually in 2002 and 2003.

- The Act extends the $13.25-per-proof-gallon coverover rate to Puerto Rico and the Virgin Islands for two additional years, through 2003.

- The excise tax on failures to comply with mental health parity requirements is amended to apply to benefits for such services provided on or after January 10, 2002, and before January 1, 2004.

- The Act suspends the special deduction limitations under section 809 for 2001, 2002 and 2003. Mutual insurance companies will be permitted to deduct policy holder dividends in full and will not be required to reduce any deduction for changes in reserves by the mutual insurance company's differential earnings amount (the difference between the average earnings rate of the 50 largest stock life insurance companies and the earnings rate of all mutual insurance companies).

- The Archer MSA program is extended for another year, through December 31, 2003.

- The Act extends for one year (i.e., through 2004) the Indian employment credit and the accelerated depreciation rules for property on Indian Reservations.

- The Act extends for five years the present-law temporary exception from the subpart F foreign personal holding company rules for certain income derived in the active conduct of a banking, financing, or insurance business.

- The Act repeals the dyed-fuel requirement for registered diesel and kerosene terminals, effective January 1, 2002.

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