The Protecting Taxpayers from Tax Hikes Act: Extenders and Appropriations Bill Signed Into Law

On December 18, 2015 the President signed into law a significant tax bill that combines various extender provisions with an appropriations package (referred to herein as The Path Act). This alert summarizes the key provisions impacting the investment management industry.

Investment managers

Research and experimentation credit – Under the Path Act legislation, the research credit is made permanent. For taxable years beginning after 2015, the credit is modified to allow an eligible small business (as defined in section 38(c)(5)(C)) to claim the credit against both its regular tax and alternative minimum tax (AMT) liabilities. Beginning in 2016, certain small businesses also may claim the credit against the employer portion of their payroll tax liability, rather than against their income tax liability. Proposed Regulations issued by the US Treasury Department (Treasury) earlier this year may make it easier for investment managers to claim a research credit for software development, including trading algorithms.

Increased expensing limits under section 179 – The Act makes permanent the increased expensing limit and phase-out threshold under section 179 – $500,000 and $2 million, respectively – which most recently lapsed at the end of 2014. (Under current law, those amounts have fallen to $25,000 and $200,000, respectively). Additionally, the extenders bill permanently allows taxpayers to expense off-the-shelf computer software and qualified real property (i.e., qualified leasehold improvement property and qualified retail improvement property) under section 179 – provisions that also lapsed at the end of 2014. For taxable years beginning after 2015, the bill (1) indexes the expensing limits to inflation, (2) repeals the limitation on the amount of section 179 property that can be attributable to qualified real property, and (3) adds air conditioning and heating units to the definition of qualifying property. To the extent a section 179 deduction is not taken, the Act changes the depreciation period for qualified leasehold improvements to 15-year straight-line cost recovery from 39.5 year straight-line.

Bonus depreciation – The PATH Act extends, but does not make permanent, bonus depreciation for qualified property placed in service over the next five years (i.e., through 2019), subject to a phase-out schedule: 50 percent bonus depreciation continues for 2015, 2016, and 2017, with the percentage falling to 40 percent in 2018, and 30 percent in 2019.

Private equity and venture capital provisions

The PATH Act permanently extends the 100 percent gain exclusion for Qualified Small Business Stock, including the elimination of the exclusion as an AMT preference item.

Regulated investment company provisions

Withholding provisions - The Path Act makes permanent the provisions under section 871(k), which allow a RIC to pay-through short-term capital dividends and interest related dividends to U.S. nonresident shareholders. This provision is effective for taxable years beginning after December 31, 2014.

FIRPTA provisions - The Path Act makes permanent the provisions under section 897(h) regarding a RIC's status as a qualified investment entity under the Foreign Investment in Real Property Tax Act (FIRPTA).

This provision takes effect January 1, 2015 but generally does not apply with respect to the requirement to withhold under section 1445 prior to the date of enactment of the Path Act.

General provisions

FIRPTA exception for certain stock of real estate investment trusts - The legislation amends the FIRPTA rules in a number of helpful ways. It increases, from 5 percent to 10 percent, the maximum ownership percentage for foreign owners of publicly traded REITs (and other entities) who are not subject to FIRPTA on sales of that stock or on capital gain distributions. It creates a new exception from FIRPTA for certain listed and traded investment entities owned by foreign persons in certain treaty countries. Finally, in applying the foreign ownership limitation for purposes of determining whether a REIT is a domestically controlled REIT, the legislation permits a publicly traded REIT to treat all of its own 5 percent-or-less shareholders as US persons unless it has actual knowledge to the contrary. If, and only if, a publicly traded REIT is a domestically controlled REIT under this standard, it would itself be treated as a US person for purposes of determining the status of a REIT in which it own shares. If a REIT that is not publicly traded owns stock in another REIT, for purposes of determining the status of the second REIT, the stock owned by the first REIT is considered owned by a US person in the same proportion as the first REIT is itself owned by US persons. These rules generally apply to sales after the date of enactment and to REIT distributions after the date of enactment with respect to taxable years ending after the date of enactment.

Amendment of IRS Audit Provisions Contained in the Bipartisan Budget Act of 2015 - The Path Act includes several technical corrections to rules streamlining Internal Revenue Service audits of large partnerships that were enacted earlier this year in the Bipartisan Budget Act of 2015.

> *Publicly Traded Partnership Provision* – The Path Act provides that the Secretary will establish procedures for determining the imputed underpayment of a publicly traded partnership without regard to the portion attributable to a net decrease in a specified passive activity loss allocated to a specified partner, and for the partnership to take the net decrease into account as an adjustment in the adjustment year with respect to the specified partners. In other words, the publicly traded partnership can reduce the tax it might owe on an imputed underpayment by passive losses it can demonstrate that a partner (that would have been allocated additional income) has with respect to that publicly traded partnership.
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> *Amended Schedule K-1s* – The Path Act clarifies that a partnership generally may not amend Schedule K-1s furnished to partners after the due date of the partnership return [including extensions]. Rather, the partnership would be required to file a request for an administrative adjustment for the amounts/items that need to be adjusted. The partnership would be required to follow the procedures outlined in the Bipartisan Budget Act of 2015.

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