Chapter 1: New Legislation

American Taxpayer Relief Act of 2012 .... A1
Individual Provisions A1
Estate, Gift, and Generation-Skipping Transfer Taxes A15
Business Provisions... A17
Energy-Related Provisions............................. A24

Corrections were made to this workbook through January of 2014. No subsequent modifications were made.

AMERICAN TAXPAYER RELIEF ACT OF 2012

On January 1, 2013, Congress passed the American Taxpayer Relief Act of 2012 (ATRA), which averted the so-called fiscal cliff by delaying across-the-board sequestration cuts that were scheduled to take effect on January 1. The next day, the president signed ATRA into law. ATRA preserves the Bush-era tax cuts for individuals with taxable income of less than $400,000 and for married couples with taxable income of less than $450,000, thus permanently extending tax cuts for 98% of Americans. ATRA also permanently indexes the alternative minimum tax (AMT) for inflation, increases the tax rate on estates and gifts, increases the capital gains rate for higher-income taxpayers, and extends or modifies many expired or expiring provisions.

In addition, ATRA contains many nontax provisions, including those related to emergency unemployment benefits, Medicare and Medicaid, and an extension of the 2008 Farm Bill. It also freezes pay for members of Congress for fiscal year 2013.

The main tax-related provisions contained in ATRA are explained in the following sections.

INDIVIDUAL PROVISIONS

Tax Rates

Old Law. The 10% individual income tax bracket was created under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and was set to expire at the end of 2012. After expiration, the lowest tax rate would be 15%. Additionally, the 25%, 28%, 33%, and 35% brackets were set to expire at the end of 2012; they were to revert to 28%, 31%, 36%, and 39.6%, respectively.

New Law. The lower tax rates imposed by EGTRRA were made permanent for all but the wealthiest 2% of individual taxpayers. For single individuals with taxable income of at least $400,000, heads of households (HoH) with taxable income of $425,000 or more, married couples filing jointly (MFJ) and qualifying widow(ers) with taxable income of at least $450,000, and married couples filing separately (MFS) with taxable income of $225,000 or more, ATRA reinstates the 39.6% tax rate.

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

The following table compares the 2013 tax rates under ATRA[1] with the 2012 tax rates.

2013 ATRA Tax Rates		2012 Tax Rates	
Taxable Income (Over–But Not Over)	Rate	Taxable Income (Over–But Not Over)	Rate
Single Taxpayers			
$ 0– 8,925	10%	$ 0– 8,700	10%
8,925– 36,250	15%	8,700– 35,350	15%
36,250– 87,850	25%	35,350– 85,650	25%
87,850–183,250	28%	85,650–178,650	28%
183,250–398,350	33%	178,650–388,350	33%
398,350–400,000	35%	Over 388,350	35%
Over 400,000	39.6%		
Head of Household Taxpayers			
$ 0– 12,750	10%	$ 0– 12,400	10%
12,750– 48,600	15%	12,400– 47,350	15%
48,600–125,450	25%	47,350–122,300	25%
125,450–203,150	28%	122,300–198,050	28%
203,150–398,350	33%	198,050–388,350	33%
398,350–425,000	35%	Over 388,350	35%
Over 425,000	39.6%		
Married Filing Jointly Taxpayers and Qualifying Widow(ers)			
$ 0– 17,850	10%	$ 0– 17,400	10%
17,850– 72,500	15%	17,400– 70,700	15%
72,500–146,400	25%	70,700–142,700	25%
146,400–223,050	28%	142,700–217,450	28%
223,050–398,350	33%	217,450–388,350	33%
398,350–450,000	35%	Over 388,350	35%
Over 450,000	39.6%		
Married Filing Separately Taxpayers			
$ 0– 8,925	10%	$ 0– 8,700	10%
8,925– 36,250	15%	8,700– 35,350	15%
36,250– 73,200	25%	35,350– 71,350	25%
73,200–111,525	28%	71,350–108,725	28%
111,525–199,175	33%	108,725–194,175	33%
199,175–225,000	35%	Over 194,175	35%
Over 225,000	39.6%		

Marriage Penalty Relief

Old Law. EGTRRA increased the basic standard deduction for MFJ taxpayers to twice that of an individual filing as single. EGTRRA also increased the size of the 15% regular income tax bracket for a MFJ couple to twice the size of the corresponding bracket for a single individual filing a return. Under EGTRRA's sunset provisions, marriage penalty relief as it relates to the standard deduction and the size of the 15% bracket was to expire on December 31, 2012.

[1] Rev. Proc. 2013-15, 2013-5 IRB 444.

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

New Law. For tax years beginning after December 31, 2012, the increase in the basic standard deduction for MFJ taxpayers to twice that of an individual filing as single was made **permanent.**[2] Similarly, the increase in the size of the 15% regular income tax bracket for a MFJ couple to twice the size of the corresponding bracket for a single individual was made permanent for tax years beginning after December 31, 2012.[3]

Personal Exemption Phaseout

Old Law. When the personal exemption phaseout (PEP) is in effect, exemptions are phased out for taxpayers with adjusted gross income (AGI) above a certain level. EGTRRA repealed the PEP over a 5-year period beginning in 2006 and ending with a total repeal in 2010. Under EGTRRA's sunset provisions, the PEP repeal was not to apply to tax years beginning after December 31, 2012.

New Law. ATRA reinstates the PEP on income above a threshold amount for tax years beginning after December 31, 2012. These threshold amounts are adjusted annually for inflation. The 2013 threshold amounts are as follows.[4]

Filing Status	2013 Threshold Amount
Single	$250,000
HoH	275,000
MFJ or qualifying widow(er)	300,000
MFS	150,000

A taxpayer must reduce their personal and dependency exemptions by 2% for each $2,500 (or fraction thereof) by which the taxpayer's AGI exceeds the threshold amount. For married filing separately (MFS) taxpayers, the reduction is 2% for each $1,250 (or fraction thereof) by which AGI exceeds the threshold amount. The PEP never reduces the deduction for exemptions by more than 100%.[5]

Example 1. Steve and Melinda have an AGI of $395,000 on their 2013 joint return. They have no children or other dependents. Their AGI exceeds the threshold amount for MFJ taxpayers by $95,000 ($395,000 − $300,000). The $95,000 excess is divided by $2,500 to yield 38. This is multiplied by 2% to yield the exemption disallowance rate of 76%. Steve and Melinda's personal exemption deduction is reduced by 76%, or $2,964 for each exemption ($3,900 personal exemption for 2013 × 76%). Thus, Steve and Melinda's two exemptions are reduced to a total of $1,872 (($3,900 × 2) – ($2,964 × 2)).[6]

Itemized Deduction Limitation

Old Law. The limitation on itemized deductions for higher-income taxpayers, generally known as the Pease limitation,[7] was repealed by EGTRRA over a 5-year period beginning in 2006 and ending with a total repeal in 2010. The EGTRRA provision was extended by subsequent legislation through December 31, 2012.

New Law. For tax years beginning after December 31, 2012, ATRA reinstates the Pease limitation for taxpayers who itemize deductions and have AGIs above the threshold amounts. The threshold amounts are the same as those applicable to the PEP.

2. IRC §63(c)(2)(A).

3. IRC §1(f)(8).

4. ATRA §101(b)(3).

5. IRC §151(d)(3)(B).

6. Adapted from an example in Congressional Research Service Report R41796, *Deficit Reduction: The Economic and Tax Revenue Effects of the Personal Exemption Phaseout (PEP) and the Limitation on Itemized Deductions (Pease)* Feb. 1, 2013. [www.fas.org/sgp/crs/misc/R41796.pdf] Accessed on Feb. 12, 2013.

7. The limitation on itemized deductions was originally drafted by Representative Donald Pease of Ohio, a member of the House Ways and Means Committee, as part of the Omnibus Budget Reconciliation Act of 1990.

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

The Pease limitation reduces itemized deductions by the lesser of:

- 3% of the amount of AGI that exceeds the threshold, or
- 80% of the total amount of itemized deductions that would otherwise be allowable.[8]

Certain deductions are not subject to the Pease limitation. These include the following.

- Medical and dental expenses
- Investment interest
- Casualty and theft losses
- Gambling losses

In calculating the reduction of itemized deductions, all other limitations are applied first (e.g., the 2% threshold for miscellaneous itemized deductions and the 7.5% or 10% AGI threshold for medical expenses). The Pease limitation is then applied to the adjusted amount.[9]

Note. Starting with the 2013 tax year, medical expenses are deductible only to the extent that they exceed 10% of AGI for taxpayers younger than age 65. The AGI threshold for taxpayers age 65 and older remains at 7.5% through 2016. For more information, see the 2012 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 7: Healthcare Reform Act.

Example 2. Virginia, age 66, and Jacob, age 65, file a joint return for 2013, which shows an AGI of $385,400. Their itemized deductions before applying the Pease limitation are as follows.

Medical expenses (above 7.5% of AGI)	$ 4,000
Mortgage interest	15,000
State and local taxes	19,000
Charitable contributions	2,000
Total itemized deductions before Pease limit	$40,000

The Pease reduction is equal to the lesser of the following.

- 3% × ($385,400 AGI − $300,000 threshold for MFJ taxpayers) = $2,562
- 80% × ($40,000 total itemized deductions − $4,000 medical expenses) = $28,800

Therefore, Virginia and Jacob can claim itemized deductions of $37,438 ($36,000 − $2,562 + $4,000).[10]

Note. Both the PEP and the Pease limitation affect tax liability under the regular income tax system. However, neither PEP nor Pease affect AMT liability.

Observation. After applying the Pease limitation, the taxpayer's itemized deduction amount will never be below the standard deduction for the taxpayer's filing status.

8. IRC §68(a).

9. IRC §68(d).

10. Adapted from an example in Congressional Research Service Report R41796, *Deficit Reduction: The Economic and Tax Revenue Effects of the Personal Exemption Phaseout (PEP) and the Limitation on Itemized Deductions (Pease)* Feb. 1, 2013. [www.fas.org/sgp/crs/misc/R41796.pdf] Accessed on Feb. 12, 2013.

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

State and Local General Sales Tax Deduction

Old Law. At the election of the taxpayer, an itemized deduction may be taken for state and local general **sales** taxes in lieu of the itemized deduction for state and local **income** taxes. This provision expired on December 31, 2011.

New Law. The provision that allows a taxpayer to elect to take an itemized deduction for state and local general sales taxes in lieu of the itemized deduction for state and local income taxes was extended two years. Thus, a taxpayer may make the election for tax years **2012, 2013, or both.**[11]

Deduction for Teachers' Expenses

Old Law. An above-the-line deduction is allowed for certain unreimbursed classroom expenses of eligible educators, up to a maximum of $250 annually.[12] Thus, these expenses are deductible from gross income rather than as miscellaneous itemized deductions. This deduction is not allowed for tax years beginning after December 31, 2011.

New Law. ATRA extends the deduction for eligible educator expenses for two years, **through December 31, 2013.**

Deduction for Mortgage Insurance Premiums

Old Law. A tax deduction is allowed for individuals who purchase a home and buy qualified mortgage insurance. Mortgage insurance premiums are treated as qualified residence interest if the mortgage insurance contract was issued on or after January 1, 2007. The amount treated as interest is subject to a phaseout for taxpayers whose AGI exceeds $100,000 ($50,000 for MFS taxpayers).[13] This provision terminated for any amounts paid or accrued, or properly allocable to any period, after December 31, 2011.

New Law. ATRA extends the deductibility of qualified mortgage insurance for two years. Thus, the provision applies to qualified mortgage insurance premiums paid or accrued **on or before December 31, 2013,** as long as the premiums are not properly allocable to any period after that date.

Principal Residence Mortgage Debt Relief

Old Law. Discharges of up to $2 million ($1 million for MFS taxpayers) of cancellation of debt income (CODI) attributable to the taxpayer's principal residence were excluded from income for federal tax purposes. Only debt acquired for the purchase, construction, or substantial improvement of a principal residence qualifies for the exclusion. The debt must be secured by the residence.

The discharges must have occurred on or after January 1, 2007, and before January 1, 2013.

New Law. ATRA extends the exclusion from gross income of CODI attributable to the taxpayer's principal residence for one year. Thus, the exclusion applies to discharges of debt occurring **before January 1, 2014.**

> **Note.** For more information about the tax ramifications of mortgage debt forgiveness, see the 2013 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 3: Financial Distress.

11. IRC §164(b)(5)(A).

12. IRC §62(a)(2)(D).

13. IRC §163(h)(3)(E).

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

Parity for Exclusion from Income of Transportation Fringe Benefits

Old Law. Prior to February 17, 2009, the maximum amount that could be excluded from income as qualified transportation fringe benefits was $100 per month in combined vanpooling and transit pass benefits and $175 per month in qualified parking benefits. These limits were adjusted annually for inflation; the applicable 2009 amounts were $120 and $230, respectively.

The American Recovery and Reinvestment Act of 2009 (ARRA) increased the monthly exclusion for employer-provided vanpool and transit pass benefits to the same level as the exclusion for employer-provided parking (i.e., $230 for 2010). Subsequent legislation extended the increase through December 31, 2011.

New Law. ATRA extends the increase in the monthly exclusion for employer-provided vanpool and transit pass benefits for two years. Accordingly, the 2012 inflation-adjusted monthly exclusion amount for vanpool and transit pass benefits is increased to $240, which is the same as the inflation-adjusted amount for qualified parking benefits.[14] The inflation-adjusted amount for 2013 is $245.[15] The temporary increase enacted by ATRA **expires on December 31, 2013.[16]**

Earned Income Credit

Old Law. The earned income credit (EIC) is available to certain low-income taxpayers. The amount of the EIC generally depends on the individual's earned income, AGI, number of qualifying children, and filing status.

Several EIC provisions were set to expire on December 31, 2012. These provisions include the following.

- The simplified definition of earned income
- The use of AGI instead of modified adjusted gross income (MAGI)
- The rule allowing the EIC to be claimed against the taxpayer's AMT liability
- The increase in the credit available to taxpayers with three or more qualifying children from 40% to 45%
- The increase in the phaseout threshold for married couples to $5,000 above that for other filers

New Law. ATRA made several provisions of the EIC **permanent** for tax years beginning after 2012. These include the following.

- Earned income is taken into account in computing the EIC only if the income is includible in the taxpayer's gross income for the tax year.[17]
- The EIC is calculated using the taxpayer's AGI instead of MAGI.[18]
- The EIC can be claimed by taxpayers subject to AMT.

Additionally, the following provisions were extended **through December 31, 2017.**

- The increase in the EIC rate from 40% to 45% for taxpayers with three or more qualifying children[19]
- The increase in the phaseout threshold for married couples to $5,000 (indexed for inflation after 2009) above that for other filers[20] (After 2017, the provision added by EGTRRA that increased the phaseout threshold for MFJ taxpayers to $3,000 above that for other filers is made **permanent.[21])**

14. Rev. Proc. 2011-52, 2011-45 IRB 701.
15. Rev. Proc. 2013-15, 2013-5 IRB 444.
16. IRC §132(f).
17. IRC §32(c)(2)(A).
18. IRC §32(a)(2)(B).
19. IRC §32(b)(3)(A).
20. IRC §32(b)(3)(B)(i) .
21. IRC §32(b)(2)(B)(iii).

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

Child and Dependent Care Credit

Old Law. Taxpayers may obtain a tax credit for an applicable percentage of qualifying expenses to care for a qualifying individual while the taxpayer is working or looking for work. EGTRRA increased the amount of eligible expenses to $3,000 for one child and $6,000 for two or more children. EGTRRA also increased the maximum applicable percentage from 30% to 35%. Subsequent legislation extended the EGTRRA enhancements to the child and dependent care credit through December 31, 2012.

New Law. ATRA made the provisions relating to the increases in the amount of eligible expenses and the maximum applicable percentage **permanent** for tax years beginning after December 31, 2012.

> **Note.** For a detailed discussion about the child and dependent care credit, see pages 130–139 in the 2011 *University of Illinois Federal Tax Fundamentals* workbook. This can be found at **www.taxschool.illinois.edu/taxbookarchive.**

Child Tax Credit

Old Law. Taxpayers with income under certain threshold amounts may claim a tax credit for each qualifying child under the age of 17. The maximum credit was $1,000 through 2012 and was scheduled to decrease to $500 thereafter.

Taxpayers are eligible for an additional refundable child tax credit equal to 15% of earned income in excess of a threshold amount. This threshold was reduced from $10,000 to $3,000 through December 31, 2012.

New Law. A provision in ATRA **permanently** extended the maximum child tax credit to $1,000 per eligible child.

The child tax credit remains partially refundable using an earned income formula that is equal to 15% of a family's earnings in excess of a threshold amount. The **reduced threshold** amount of $3,000 applies to tax years **through December 31, 2017.**[22] For families with three or more children, the refundable portion of the child tax credit must be calculated as the amount by which the taxpayer's social security taxes exceed the taxpayer's EIC, if the calculation results in a greater refundable credit.[23]

Refunds Disregarded in Determining Eligibility for Federal Benefits

Old Law. Qualifying individuals receive refundable credits under various provisions of the Code. Tax refunds and advance payments of refundable credits received by individuals after December 31, 2009, and before January 1, 2013, may not be taken into account over a 12-month period as a resource for purposes of determining the individual's eligibility for benefits or assistance under any federal program or under any state or local program financed with federal funds.

New Law. For all years beginning after December 31, 2012, ATRA makes the provision **permanent** that disregards all refundable tax credits as income for means-tested programs.

Adoption Credit and Employer-Provided Adoption Assistance

Old Law. Taxpayers with qualified adoption expenses may be eligible for the adoption credit and/or an exclusion from income for employer-provided adoption assistance. EGTRRA increased the dollar limitation for the adoption credit and the income exclusion to $10,000, indexed for inflation. Both the adoption credit and the income exclusion phase out for taxpayers with MAGI between $150,000 and $190,000, indexed for inflation. The increases to the dollar limitation and the phaseout range do not apply to tax years after 2012.

---

22. IRC §24(d)(4).

23. IRC §24(d)(1)(B)(ii).

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

New Law. The EGTRRA enhancements to the adoption credit and employer-provided adoption assistance were made **permanent** for tax years beginning after December 31, 2012. Accordingly, for 2013, the inflation-adjusted maximum adoption credit and income exclusion for employer-provided adoption benefits is $12,970. The phaseout range applies to taxpayers with MAGI between $194,580 and $234,580.[24]

> **Note.** For more information about the adoption credit, see the 2012 *University of Illinois Federal Tax Workbook,* Volume C, Chapter 2: Credits.

IRA Distributions for Charitable Purposes

Old Law. Individuals may exclude qualified charitable distributions (QCD) from gross income for otherwise taxable IRA distributions. A QCD is a distribution from an IRA that is made directly by the IRA trustee to a charitable organization on or after the date the IRA owner reaches age 70½.[25] A taxpayer's exclusion may not exceed $100,000 per tax year. The QCD exclusion is not available for tax years beginning after December 31, 2011.

New Law. ATRA extends the income exclusion for QCDs through **December 31, 2013.**

ATRA contains a special rule that permits taxpayers to elect to treat a contribution made to a qualified charity in January 2013 as a 2012 QCD in either of the following circumstances.[26]

1. The contribution is a cash contribution to the charity of all or a portion of an IRA distribution made to the IRA owner in December 2012, provided that the contribution would have been a 2012 QCD if it had been paid directly from the IRA to the charity in 2012.
2. The contribution is paid directly from the IRA to the charity, provided that the contribution would have been a 2012 QCD if it had been paid in 2012.

A QCD made in January 2013 that is treated as a 2012 QCD can be used to satisfy the IRA owner's 2012 required minimum distribution (RMD). In determining the RMD for 2013, the 2012 QCD must be subtracted from the December 31, 2012 IRA account balance.[27]

> **Observation.** January 2013 QCD amounts are reported on 2013 Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*

Contributions of Real Property for Conservation Purposes

Old Law. Contributions of capital gain property to certain charitable organizations are generally deductible up to 30% of the taxpayer's contribution base. For contributions made in tax years beginning after December 31, 2005, the 30% contribution base limit on contributions of capital gain property by individuals does not apply to qualified conservation contributions. Instead, individuals may deduct the fair market value (FMV) of any qualified conservation contribution to an organization described in IRC §170(b)(1)(A) (i.e., public charities, private foundations, and certain governmental units), subject to a 50% contribution base limit.[28] Excess contributions may be carried forward up to 15 years.

---

24. Rev. Proc. 2013-15, 2013-5 IRB 444.
25. IRC §408(d)(8)(B).
26. *Charitable Donations from IRAs for 2012 and 2013.* [www.irs.gov/Retirement-Plans/Charitable-Donations-from-IRAs-for-2012-and-2013] Accessed on Feb. 15, 2013.
27. Ibid.
28. IRC §170(b)(1)(E)(i).

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

Qualified farmers and ranchers are allowed to deduct qualified conservation contributions of up to 100% of the excess of the taxpayer's contribution base over the amount of all other allowable charitable contributions.[29]

The special rules that apply to contributions of capital gain real property for conservation purposes do not apply to contributions made in tax years beginning after December 31, 2011.

New Law. ATRA extends the special rules applicable to contributions of capital gain real property for conservation purposes for two years. Thus, the rules apply to contributions made through **December 31, 2013.**

In-Plan Roth Conversions

Old Law. Some employers offer their employees the option of contributing some of their after-tax compensation to designated Roth plans. At the end of 2010, the Small Business Jobs Act (SBJA) was signed into law, which permitted in-plan Roth rollovers from retirement plan funds (e.g., traditional 401(k), 403(b), and 457 plans) that were eligible for distribution to a designated Roth contribution program in the same plan. However, funds eligible for the in-plan Roth rollover had to be otherwise eligible to be withdrawn or "distributable" under the retirement plan. This meant that employees who had attained age 59½ could elect to roll over their vested balance from a traditional 401(k) plan to a Roth 401(k), but other employees would not necessarily be eligible for these conversions.[30]

When an employee elects to convert a non-Roth account to a Roth account, the employee pays tax at the time the funds are rolled over or converted. The 10% additional tax on early distributions imposed under IRC §72(t) does not apply to the rollover distributions.

New Law. ATRA expanded the changes made by the SBJA to allow virtually all traditional 401(k), 403(b), and 457 plan account balances to be transferred to designated Roth contribution programs. This effectively removes the requirement that funds from these accounts be otherwise "distributable." This provision applies to transfers made **after December 31, 2012.**

American Opportunity Credit

Old Law. The American opportunity credit (AOC) is a modification of the Hope credit that was set to expire on December 31, 2012. The maximum annual AOC amount is $2,500 per eligible student for qualified education expenses (including course materials) paid for each of the first four years of the student's post-secondary education in a degree or certificate program. Forty percent of the AOC is refundable.

The AOC is phased out for taxpayers with MAGI between $80,000 and $90,000 ($160,000 and $180,000 for MFJ taxpayers). The phaseout ranges are not indexed for inflation.

New Law. ATRA extends the AOC through **December 31, 2017.**

Note. For a thorough explanation of the AOC, see Chapter 2: Education, in the 2011 *University of Illinois Federal Tax Fundamentals* workbook. This can be found at **www.taxschool.illinois.edu/taxbookarchive.**

Coverdell Education Savings Accounts

Old Law. EGTRRA increased the amount that may be contributed annually to Coverdell education savings accounts (ESA) from $500 to $2,000 per designated beneficiary. Distributions from Coverdell ESAs are excludable from the gross income of the beneficiary if the amount of the distribution does not exceed the qualified education expenses incurred during the year. Qualified education expenses under EGTRRA include elementary and secondary education expenses as well as higher education expenses.

---

29. IRC §170(b)(1)(E)(iv)(I).

30. Congressional Research Service Report R42894, *An Overview of the Tax Provisions in the American Taxpayer Relief Act of 2012.* Jan. 10, 2013. [www.fas.org/sgp/crs/misc/R42894.pdf] Accessed on Feb. 12, 2013.

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

For tax years beginning after December 31, 2012, the following changes made by EGTRRA and extended by subsequent legislation were scheduled to expire.

- The increase in the contribution limit from $500 to $2,000
- The increase in the phaseout range for MFJ taxpayers to $190,000–$220,000 (For other filers, the phaseout range remains at $95,000–$110,000.)
- The expansion of qualified education expenses to include elementary and secondary education expenses
- A waiver of age limitations for special-needs beneficiaries
- Clarification that corporations and other entities are permitted to make contributions, without regard to the entities' income during the year
- Rules pertaining to the time when contributions are deemed to have been made and extending the time during which excess contributions may be returned without incurring additional tax
- Rules regarding coordination with the Hope and lifetime learning credits and qualified tuition programs

New Law. The increased Coverdell ESA contribution limits and the other EGTRRA provisions specified above were made **permanent** by ATRA.

> **Note.** For a thorough explanation of Coverdell ESAs, see Chapter 2: Education, in the 2011 *University of Illinois Federal Tax Fundamentals* workbook. This can be found at **www.taxschool.illinois.edu/taxbookarchive.**

Income Exclusion for Employer-Provided Educational Assistance

Old Law. Up to $5,250 of educational assistance provided by an employer to an employee may be excluded annually from gross income for income tax purposes and from wages for employment tax purposes.[31] The exclusion is allowable for both graduate and undergraduate courses. Certain requirements must be satisfied in order for the exclusion to apply.

The exclusion was set to expire on December 31, 2012. At that time, educational assistance would be excludable only if it qualified as a working condition fringe benefit.

New Law. Under ATRA, the exclusion from gross income for up to $5,250 of employer-provided educational assistance is made **permanent** for tax years beginning after December 31, 2012.

Income Exclusion for Qualified Scholarships

Old Law. Gross income does not include amounts received from qualified scholarships by individuals who are degree candidates.[32] The amount of the scholarship must be used for tuition and fees required for enrollment or attendance at a primary, secondary, or post-secondary educational institution.

The exclusion of qualified scholarships from gross income does not apply to any amount that represents payment for teaching, research, or other services that the student is required to perform as a condition for receiving the scholarship. An exception applies in the case of the National Health Service Corps Scholarship Program (NHSC Scholarship Program) and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program (the Armed Forces Scholarship Program), which provide education awards to participants on the condition that the participants perform certain services.

---

31. IRC §§127 and 3121(a)(18).

32. IRC §117(a).

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

The exclusion for the NHSC Scholarship Program and the Armed Forces Scholarship Program was scheduled to expire after December 31, 2012.

New Law. For all years after December 31, 2012, ATRA **permanently extends** the income exclusion for amounts received under the NHSC Scholarship Program and the Armed Forces Scholarship Program.

Deduction for Qualified Tuition and Related Expenses

Old Law. Individuals are allowed an above-the-line deduction for qualified tuition and related higher education expenses paid during the tax year. The maximum deduction is $4,000 for an individual whose AGI for the year does not exceed $65,000 ($130,000 for MFJ taxpayers) or $2,000 for other individuals whose AGI does not exceed $80,000 ($160,000 for MFJ taxpayers). Taxpayers with AGIs above $80,000 ($160,000 MFJ) are not entitled to a deduction.

The deduction was set to expire on December 31, 2011.

New Law. ATRA extends the above-the-line qualified tuition deduction for two years. Thus, it is available for expenses paid by the taxpayer through **December 31, 2013.**

Student Loan Interest Deduction

Old Law. Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for the interest. The maximum allowable deduction is $2,500 per year. For 2012, the deduction is phased out for taxpayers whose MAGI is between $60,000 and $75,000 ($125,000 and $155,000 for MFJ taxpayers).

For tax years beginning after December 31, 2012, the phaseout ranges were scheduled to revert to lower pre-EGTRRA levels. Additionally, the EGTRRA change that extended the deductibility of interest beyond the first 60 months that interest payments are required was to expire at that time.

New Law. Under ATRA, the MAGI phaseout ranges for purposes of the student loan interest deduction are made **permanent.** For the 2013 tax year, the $2,500 maximum allowable deduction is phased out for taxpayers with MAGI between $60,000 and $75,000 ($125,000 and $155,000 for MFJ taxpayers).[33]

In addition, the EGTRRA change that extended the deductibility of interest beyond the first 60 months was made **permanent.** Therefore, eligible taxpayers can deduct interest on qualified education loans after December 31, 2012, even if the interest is paid more than five years after the date that interest payments on the loan were first required.

Alternative Minimum Tax Relief

Old Law. The AMT was originally designed to ensure that higher-income taxpayers who owed little or no regular income tax because of tax preference items would still pay tax. Under the AMT, taxpayers first add back certain tax preference items to their taxable income to determine the income subject to AMT (the AMT tax base). Taxpayers then subtract an exemption amount from their AMT tax base.

Prior to passage of ATRA, these exemption amounts were not indexed for inflation. AMT "patches" that temporarily increased the exemption amount were extended several times. The latest patch expired on December 31, 2011. The AMT exemption amounts for 2011 were $74,450 for MFJ taxpayers and $48,450 for unmarried taxpayers. These exemption amounts would have reverted to $45,000 for MFJ taxpayers and $33,750 for unmarried taxpayers for tax years beginning in 2012.[34]

Additionally, previous AMT patches included provisions that allowed taxpayers to reduce their AMT liability by nonrefundable personal tax credits. If the AMT patch had been allowed to lapse, most of the nonrefundable personal credits would no longer have been allowed against the AMT.

---

33. Rev. Proc. 2013-15, 2013-5 IRB 444.

34. Congressional Research Service Report R42894, *An Overview of the Tax Provisions in the American Taxpayer Relief Act of 2012*. Jan. 10, 2013. [www.fas.org/sgp/crs/misc/R42894.pdf] Accessed on Mar. 28, 2013.

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

New Law. ATRA **permanently** indexed the AMT exemption amounts for inflation for tax years beginning after December 31, 2011. The following table shows the exemption amounts for 2012[35] and 2013.[36]

Filing Status	2012	2013
MFJ and QW	$78,750	$80,800
Single	50,600	51,900
MFS	39,375	40,400
Estates and trusts	22,500	23,100

ATRA also includes a provision that **permanently** allows nonrefundable personal credits to be claimed against the AMT.

Capital Gains Tax Rates

Old Law. For tax years beginning after 2007 and before 2012, to the extent that individuals are in the 10% or 15% tax bracket, their adjusted net capital gains are taxed at 0%. For individuals in higher brackets, net capital gains are taxed at 15%. These rates apply for both regular tax and AMT purposes.

The taxpayer's "adjusted net capital gain" is the net long-term capital gain reduced by all of the following.

- Gain on collectibles[37]
- Net gain from qualified small business stock[38]
- Unrecaptured IRC §1250 gain

Prior to passage of ATRA, individuals in the 10% and 15% tax brackets were to have capital gains taxed at a 10% rate after 2012. Individuals in higher brackets would have net capital gains taxed at the maximum 20% rate.

New Law. Under ATRA, the tax rates in effect before 2013 for adjusted net capital gains are made **permanent, except** for the following.

- The 15% rate applies only to adjusted net capital gains that would otherwise be taxed at a rate below the 39.6% rate for regular tax purposes.
- A 20% rate applies to amounts that would otherwise be taxed at a 39.6% ordinary income tax rate.

35. IRC §55(d)(1), as amended by ATRA.
36. Rev. Proc. 2013-15, 2013-5 IRB 444.
37. See IRC §408(m).
38. See IRC §1202.

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

The following table summarizes the 2013 capital gains rates for individuals, trusts, and estates.

Ordinary Income Tax Rate	2013 Income Amount		Capital Gains Rate
Below top of 15% bracket	Single	$ 0– 36,250	0%
	HoH	0– 48,600	
	MFJ and QW	0– 72,500	
	MFS	0– 36,250	
	Trusts/estates	0– 2,400	
Above top of 15% bracket and below threshold of 39.6% bracket	Single	36,251–400,000	15%
	HoH	48,601–425,000	
	MFJ and QW	72,501–450,000	
	MFS	36,251–225,000	
	Trusts/estates	2,401– 11,950	
Above threshold for 39.6% bracket	Single	Above 400,000	20%
	HoH	Above 425,000	
	MFJ and QW	Above 450,000	
	MFS	Above 225,000	
	Trusts/estates	Above 11,950	

In order to calculate the tax on capital gains, it is necessary to apply the ordering rules of IRC §1(h)(1).

Step 1. Determine the amount of taxable income taxed at ordinary income tax rates. This is the **greater** of the following.

- **a.** Taxable income reduced by the net capital gain
- **b.** The lesser of the following
  - The amount of income taxed at a rate below 25%
  - Taxable income reduced by the adjusted net capital gain

Step 2. Determine the income taxed at the 0% rate. This is the **lesser** of the following.

- **a.** The taxpayer's adjusted net capital gain (or taxable income, if lower)
- **b.** The top of the 15% tax bracket for the taxpayer's filing status, minus the taxpayer's regular taxable income (taxable income less adjusted net capital gain)

Step 3. Determine the income taxed at the 15% rate. This is the **lesser** of the following.

- **a.** The taxpayer's adjusted net capital gain (or taxable income, if lower) in excess of the amount taxed at 0%
- **b.** The top of the 35% tax bracket for the taxpayer's filing status, minus the taxable income taxed under the previous two steps

Step 4. Calculate the adjusted net capital gain remaining after the application of **Steps 2** and **3.** This amount is taxed at 20%.

Step 5. Apply a 25% tax rate to any unrecaptured §1250 gain.

Step 6. Apply a 28% tax rate to any gain from collectibles and qualified small business stock.

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

Example 3. Catalina and Rexford have ordinary income of $375,000 and long-term capital gains of $225,000 on their 2013 joint tax return. Their taxable income after deductions is $551,500. None of their net capital gain is from the disposition of collectibles, qualified small business stock, or §1250 property. Catalina and Rexford's tax on capital gains can be determined by following the ordering rules of §1(h)(1).

Step 1. Determine the amount of taxable income taxed at ordinary income tax rates. This is the **greater** of the following.

a. Taxable income reduced by the net capital gain, or **$326,500** ($551,500 − $225,000)

b. The lesser of the following

- The top of the 15% tax bracket for the taxpayer's filing status, or **$72,500**
- Taxable income reduced by the adjusted net capital gain, or $**326,500** ($551,500 − $225,000)

Therefore, the amount of Catalina and Rexford's taxable income taxed at ordinary income tax rates is $326,500. This means that even though Catalina and Rexford have total taxable income of $551,500, none of it is taxed at the 39.6% tax rate. In fact, 33% is their highest marginal tax rate.

Step 2. Determine the capital gains taxed at the 0% rate. This is the **lesser** of the following.

a. The taxpayer's adjusted net capital gain (or taxable income, if lower), **or $225,000**

b. The top of the 15% tax bracket for the taxpayer's filing status, minus the taxpayer's regular taxable income (taxable income less adjusted net capital gain), **or $0** ($72,500 – ($551,500 − $225,000))

Therefore, none of Catalina and Rexford's capital gains are taxed at the 0% rate.

Step 3. Determine the capital gains taxed at the 15% rate. This is the **lesser** of the following.

a. The taxpayer's adjusted net capital gain (or taxable income, if lower) in excess of the amount taxed at 0%, or **$225,000** ($225,000 −$0)

b. The top of the 35% tax bracket for the taxpayer's filing status, minus the income taxed under the previous two steps, or **$123,500** ($450,000 − $326,500)

Therefore, $123,500 of Catalina and Rexford's capital gains are taxed at the 15% rate.

Step 4. Calculate the adjusted net capital gain remaining after the application of **Steps 2** and **3.** This amount is taxed at 20%.

The amount of Catalina and Rexford's capital gains taxed at the 20% rate is **$101,500** ($225,000 − $123,500).

Step 5. Not applicable

Step 6. Not applicable

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

To summarize, Catalina and Rexford's **net capital gains** are taxed as follows.

Amount	Rate	Tax
$123,500	15%	$18,525
101,500	20%	20,300
$225,000		$38,825

Note. Starting in 2013, higher-income taxpayers are also subject to a 3.8% additional Medicare tax on net investment income. Higher-income taxpayers for purposes of the additional Medicare tax are those whose MAGI exceeds $200,000 for single taxpayers, $250,000 for MFJ taxpayers, and $125,000 for MFS taxpayers. For more information about the additional Medicare tax, see the 2013 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 2: Affordable Care Act Update.

Caution. The phaseout of personal exemptions and itemized deductions may also impact the effective capital gain rate. Multi-year planning strategies should be considered to optimize the effective tax rate on large capital gains.

Tax Rates on Dividends

Old Law. Qualified dividend income is taxed to an individual at the same rates that apply to net capital gains for both regular tax and AMT purposes. For tax years beginning after 2007 and before 2011, individuals in the 10% or 15% tax bracket have their qualified dividend income taxed at 0%. For individuals in higher brackets, qualified dividends are taxed at 15%.

Prior to the passage of ATRA, qualified dividends received by individuals after 2012 were to be taxed at ordinary income tax rates.

New Law. Under ATRA, the preferential rates for qualified dividends are extended **permanently.** Thus, for tax years beginning after December 31, 2012, qualified dividends are taxed at the same rates (0%, 15%, and 20%) that apply to capital gains.

ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAXES

Exemption Amounts and Tax Rates

Old Law. After 2010, a unified credit applies to taxable transfers by gift and at death. The unified credit offsets tax computed at the lowest estate and gift tax rates on a specified amount of transfers. This is referred to as the **applicable exclusion amount.**

The applicable exclusion amount for estate and gift tax purposes is $5 million for 2010 and is indexed for inflation for decedents dying after 2011. The inflation-adjusted applicable exclusion amount for 2012 is $5.12 million. The maximum estate and gift tax rate is 35%.

The generation-skipping transfer tax (GSTT) exemption is the same as the exclusion amount for estate tax purposes (e.g., $5.12 million for 2012). For transfers made after 2010, the GSTT rate is equal to the highest estate and gift tax rate in effect for the year (e.g., 35% for 2011 and 2012).

Before the passage of ATRA, the estate tax, GSTT, and gift tax were scheduled to revert to pre-EGTRRA rules after December 31, 2012. Under those rules, the applicable exclusion amount would have been $1 million, and the maximum tax rate would have been 55%.

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

New Law. Under ATRA, the inflation-adjusted applicable exclusion amount for 2013 is $5.25 million. The corresponding GSTT exemption amount is also $5.25 million for 2013. The increased applicable exclusion and exemption amounts are made **permanent** for years starting after December 31, 2012.

The maximum tax rate that applies to taxable transfers is increased from 35% to 40% for years starting after December 31, 2012.

Note. For more information about gift taxes, see the 2013 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 3: Advanced Individual Issues.

Portability of Unused Exemption between Spouses

Old Law. Under a temporary provision enacted as part of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Tax Relief Act), any applicable estate tax exclusion amount that remains unused at the date of death of a spouse who dies after December 31, 2010, and before January 1, 2013, generally is available for use by the surviving spouse, in addition to the surviving spouse's applicable exclusion amount. However, a surviving spouse cannot use the unused GSTT exemption of a predeceased spouse.[39]

A surviving spouse may use a deceased spousal unused exclusion amount **only if an election is made on a timely filed estate tax return of the predeceased spouse,** even if the predeceased spouse is otherwise not required to file an estate tax return. If a surviving spouse is predeceased by more than one spouse, the amount of the unused exclusion available for use by the surviving spouse is limited to the lesser of $5 million (adjusted for inflation) or the unused exclusion of the **last deceased spouse.**

The portability provision was scheduled to expire on December 31, 2012.

New Law. The **portability** provision is made **permanent** for the estates of decedents dying after December 31, 2012.

Example 4. Norbert died in 2012, having made taxable transfers of $3 million. He has no taxable estate. An election is made on Norbert's estate tax return to permit his wife, Azalea, to use Norbert's unused exclusion amount.

Azalea has not made any taxable gifts. If she dies in 2013, her applicable exclusion amount will be $7.37 million (her $5.25 million applicable exclusion amount plus Norbert's unused exclusion amount of $2.12 million).

Note. Practitioners should consider advising their clients to file a Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return,* even if the decedent has no taxable estate, in order to preserve the portability of the unused estate tax exclusion. Practitioners are advised to retain a written record of a taxpayer's decision **not** to file Form 706.

State Death Tax Deduction

Old Law. Before 2005, a credit was allowed against the federal estate tax for any estate, inheritance, legacy, or succession taxes ("death taxes") that were paid to any state on any property included in a decedent's estate.[40] Under EGTRRA, the amount of the credit allowed for state death taxes was reduced from 2002 through 2004. For individuals who died after 2004, the state death tax credit was repealed entirely and replaced with a deduction for death taxes paid to any state on property included in a decedent's estate.[41]

---

39. Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 112th Congress.* JCS-2-13 (Feb. 2013).

40. IRC §2011(a).

41. IRC §2058.

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

The Tax Relief Act extended the EGTRRA provisions in regard to the state death tax deduction through 2012. Thus, for decedents who died in 2011 and 2012, the state death tax credit was repealed and replaced with a deduction for state death taxes paid.

New Law. ATRA **permanently** extends the deduction for state death taxes paid for tax years beginning after December 31, 2012.

BUSINESS PROVISIONS

Bonus Depreciation

Old Law. Bonus first-year depreciation applies to qualified property placed in service after December 31, 2007, and before January 1, 2013. To calculate bonus depreciation, the percentage shown in the following table is applied to the adjusted basis of the property.

Date Property Placed in Service	Percentage
January 1, 2008–September 8, 2010	50%
September 9, 2010–December 31, 2010	100% or 50% [a]
January 1, 2011–December 31, 2011	100%
January 1, 2012–December 31, 2012	50%

[a] Using the election pursuant to Rev. Proc. 2011-26.

An extension of one year in the placed-in-service date applies to certain longer-lived and transportation property. Bonus depreciation is mandatory unless a taxpayer elects out for one or more classes of property for any tax year.

New Law. Under ATRA, 50% bonus depreciation is extended for one additional year. Thus, it generally applies to qualified property placed in service through **December 31, 2013,** and through December 31, 2014, for certain longer-lived and transportation property.

Note. For a thorough explanation of bonus depreciation, see the 2011 *University of Illinois Federal Tax Workbook,* Chapter 1: Depreciation. This can be found at **www.taxschool.illinois.edu/taxbookarchive.**

IRC §179 Expensing Election

Old Law. For tax years beginning in 2010 and 2011, the maximum amount a taxpayer can elect to expense under IRC §179 is $500,000 of the cost of qualifying property placed in service during the year. The maximum amount is reduced on a dollar-for-dollar basis when the amount of qualifying property placed in service during the year exceeds $2 million. For tax years beginning in 2010 and 2011, qualifying property includes certain real property (i.e., qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).[42] The maximum amount of qualified real property that may be expensed is $250,000 for 2010 and 2011. For tax years beginning in 2012 and thereafter, qualifying property includes depreciable tangible personal property purchased for use in the active conduct of a trade or business. For tax years beginning before 2013, off-the-shelf computer software is also treated as qualifying property.

42. IRC §179(f).

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

Before the passage of ATRA, the maximum amount a taxpayer could expense under §179 for tax years beginning in 2012 was scheduled to drop to $125,000 (indexed for inflation). The maximum amount was to be reduced on a dollar-for-dollar basis when the amount of qualifying property placed in service during the year exceeded $500,000 (indexed for inflation). For tax years beginning after 2012, the maximum amount a taxpayer could expense under §179 was to further decrease to $25,000. This maximum amount was to be reduced by the amount by which the cost of qualifying property placed in service during the tax year exceeded $200,000. The $25,000 and $200,000 limits are not indexed for inflation.

New Law. For tax years beginning in 2012 and 2013, ATRA extends the maximum amount that a taxpayer can deduct under §179 to $500,000. The maximum amount is reduced on a dollar-for-dollar basis when the amount of qualifying property placed in service during the year exceeds $2 million. The $500,000 and $2 million limits are not indexed for inflation.

ATRA extends the treatment of off-the-shelf computer software as qualifying property for tax years beginning in 2013. The treatment of **qualified real property** as qualifying §179 property is also extended for tax years beginning in 2012 and 2013, including the **$250,000** expensing limitation for each tax year. Amounts attributable to qualified real property that are disallowed because of the taxable income limitation may only be carried over to tax years in which qualified real property is included in the definition of eligible §179 property.[43]

For tax years beginning in 2013, ATRA provisions continue to permit a taxpayer to amend or revoke a §179 election without the consent of the IRS.

> **Note.** For a thorough explanation of the rules pertaining to §179 deductions, see the 2011 *University of Illinois Federal Tax Workbook,* Chapter 1: Depreciation. This can be found at **www.taxschool.illinois.edu/taxbookarchive.**

15-Year Depreciation for Qualified Improvements

Old Law. The following types of property are eligible for a 15-year recovery period, using the straight-line method and a half-year convention.

- Qualified leasehold improvements[44] placed in service before January 1, 2012
- Qualified restaurant property[45] placed in service before January 1, 2012
- Qualified retail improvement property[46] placed in service before January 1, 2012

New Law. ATRA extends the provision allowing a 15-year recovery period for qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property for two years. Therefore, 15-year straight-line depreciation applies to qualified property placed in service **on or before December 31, 2013.**

> **Note.** For further information about the 15-year depreciation allowed for qualified improvements, see the 2013 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 2: Small Business Issues.

43. See IRC §179(f)(4).
44. IRC §168(e)(3)(E)(iv).
45. IRC §168(e)(3)(E)(v).
46. IRC §168(e)(3)(E)(ix).

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

Employer-Provided Childcare Tax Credit

Old Law. Employers may claim a tax credit of 25% of qualified expenses for employee childcare and 10% of qualified expenses for childcare resource and referral services. The maximum annual credit an employer can claim is $150,000.

Qualified childcare expenditures include the amounts paid or incurred for the following purposes.[47]

- Acquiring, constructing, rehabilitating, or expanding property to be used as part of the qualified childcare facility
- Operating the qualified childcare facility
- Contracting with a qualified childcare facility to provide childcare services to employees

This tax credit was set to expire for tax years beginning after December 31, 2012.

New Law. ATRA **permanently** extends the employer-provided childcare tax credit for tax years beginning after December 31, 2012.

Work Opportunity Tax Credit

Old Law. The work opportunity tax credit (WOTC) is available to employers hiring individuals from a targeted group. The targeted groups consist of the following.[48]

1. **Temporary Assistance for Needy Families Program (TANF) recipients.** This group includes families receiving TANF assistance for at least nine months, part of which is during the 18-month period ending on the hire date.
2. Qualified veterans

> **Note.** For a thorough explanation of the rules applicable to the WOTC for qualified veterans, see the 2012 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 6: New Legislation.

3. **Qualified ex-felons.** This group includes persons convicted of a felony who are hired within one year after their release from prison or the date of conviction.
4. **Designated community residents.** This group includes individuals who are at least age 18 but not yet age 40 on the hire date and who live within one of the following areas.
   a. Empowerment zone
   b. Enterprise community
   c. Renewal community
   d. Rural renewal county
5. **Vocational rehabilitation referrals.** This group includes persons who are physically or mentally disabled and who are referred to the employer by certain rehabilitation programs.

---

47. IRC §45F(c)(1)(A).
48. Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 112th Congress.* JCS-2-13 (Feb. 2013).

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

6. **Qualified summer youth employees.** This group includes persons who are at least age 16 but not yet age 18 on the hire date and who live within one of the following areas.

   a. Empowerment zone

   b. Enterprise community

   c. Renewal community

   Only the wages paid between May 1 and September 15 and while the individual lives in a designated community qualify for the credit.

7. **Qualified supplemental nutrition assistance program benefits recipients.** This group includes recipients who are at least age 18 but not yet age 40 on the hire date. To qualify, the recipients must be members of a family receiving assistance under the Food and Nutrition Act of 2008 for a period of at least six months ending on the hire date. For families who cease to be eligible for assistance under the Food and Nutrition Act of 2008, the 6-month requirement is replaced with a requirement that the family has been receiving assistance for at least three of the five months ending on the hire date.

8. **Qualified supplemental security income (SSI) recipients.** This group includes individuals who received SSI benefits for any month ending within the 60-day period prior to the hire date.

9. **Long-term family assistance (LFA) recipients.** This group includes individuals certified by a designated local agency as being one of the following.

   a. A member of a family who has received family assistance for at least 18 consecutive months

   b. A member of a family who has received family assistance for at least 18 months after August 5, 1997, if the individual is hired within two years after the date that the 18-month total is reached

   c. A member of a family who is no longer eligible for family assistance because of either federal or state time limits if the individual is hired within two years after the time limits made the family ineligible for assistance

The credit available to an employer is generally 40% of **applicable wages.** However, the credit is limited to 25% of applicable wages if the employee has worked fewer than 400 hours for the employer. For employees who are LFA recipients, the second-year wages qualify for a 50% credit. For all other targeted groups, only the wages paid for work performed during the 1-year period beginning on the date the individual begins work for the company qualify for the credit.

The maximum amount of applicable wages for each group is as follows.

Summer youth	$ 3,000
Qualified veterans	6,000, 12,000, 14,000, or 24,000 [a]
LFA first-year wages	10,000
LFA second-year wages	10,000
All others	6,000

[a] The amount of applicable wages depends on which category the qualified veteran falls into. For more information, see 2012 Volume A, Chapter 6: New Legislation.

Prior to the passage of ATRA, the tax credit for employers of qualified veterans expired on December 31, 2012. The tax credit for all other targeted groups expired on December 31, 2011.

Note. The WOTC was extensively covered in the 2009 *University of Illinois Federal Tax Workbook,* Chapter 6: Small Business Issues. This can be found at **www.taxschool.illinois.edu/taxbookarchive.**

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

New Law. The WOTC for all targeted groups is extended **through December 31, 2013.**

Enhanced Charitable Deduction for Food Inventory Contributions

Old Law. Any taxpayer engaged in a trade or business is eligible to claim an enhanced deduction for donations of food inventory. Food inventory contributions must be items fit for human consumption and must be contributed to a qualified charity or private operating foundation for use in the care of infants, the ill, or the needy.

The amount of the enhanced deduction for food inventory donations is the **lesser** of:[49]

- The basis of the donated item plus one-half of the item's appreciation, or
- Two times the basis of the donated item.

Appreciation of the food item is defined as the amount of gain that would be realized if the donated item were sold at FMV on the date of the contribution.

Prior to the passage of ATRA, the enhanced deduction did not apply to contributions of food inventory made after December 31, 2011.

New Law. ATRA extends the enhanced deduction for contributions of food inventory for two years, **through December 31, 2013.**

Basis Adjustment to S Corporation Stock for Charitable Contributions

Old Law. When an S corporation contributes property to a charity, each shareholder's stock basis is reduced by their pro rata share of the adjusted basis of the contributed property. This provision applies to contributions made by an S corporation in tax years beginning before January 1, 2012.

For contributions made by an S corporation in tax years beginning after December 31, 2011, the amount of the reduction in basis is the shareholder's pro rata share of the FMV of the contributed property.

New Law. ATRA extends the rules pertaining to S corporation charitable contributions for two years. Thus, for contributions made by an S corporation in tax years **beginning on or before December 31, 2013,** shareholders' stock bases are reduced by their pro rata share of the adjusted basis of the contributed property.

S Corporation Built-In Gains Tax

Old Law. A built-in gains (BIG) tax is imposed on assets sold by an S corporation that it held when it was converted from a C corporation, unless the assets are held for a statutorily determined period of time. The statutory period is generally 10 years after conversion but was reduced to seven years for gains recognized in tax years beginning in 2009 and 2010.

For tax years beginning in 2011, the statutory period was further reduced to five years. Thus, a BIG tax is not imposed on converted property sold in a tax year beginning in 2011 if the fifth year in the recognition period preceded the 2011 tax year.

New Law. The 5-year statutory period for recognition of built-in gains is **extended** by ATRA **through 2013.** Thus, a BIG tax will not be imposed on converted property sold in a tax year beginning in 2012 or 2013 if the fifth year in the recognition period preceded the 2012 or 2013 tax year. The 5-year period refers to five calendar years from the first day of the first tax year for which the corporation was an S corporation.

> **Note.** For more information about the BIG tax, see the 2012 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 1: S Corporation.

---

49. IRC §170(e).

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

Qualified Small Business Stock Gain Exclusion

Old Law. Noncorporate taxpayers generally are allowed to exclude 50% of the gain from the sale of qualified small business stock held for more than five years.[50] Sixty percent of the gain on the sale of qualified small business stock from certain empowerment-zone businesses may be excluded. A percentage of the excluded gain is an AMT preference item.[51] The taxpayer must acquire the stock at **original issue** in order to be eligible for the exclusion. The limit on the gain from any single stock of a **qualifying domestic C corporation** that a taxpayer may exclude is the greater of:

- Ten times the taxpayer's basis in qualified small business stock issued by the corporation and disposed of by the taxpayer during the tax year, or
- $10 million reduced by the aggregate amount of eligible gain taken into account in prior tax years.[52]

The corporation's gross assets cannot exceed $50 million when the stock is issued. In addition, at least 80% of the value of its assets must be used in the active conduct of a qualified trade or business. A qualified trade or business means any trade or business other than the following.

- Any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business in which the principal asset is the reputation or skill of one or more of its employees
- Any banking, insurance, financing, leasing, investing, or similar business
- Any farming business
- Any business involving the production or extraction of products to which a deduction is allowable under IRC §§613 or 613A (mines, wells, and other natural deposits)
- Any business that operates a hotel, motel, restaurant, or similar business[53]

The gain exclusion for qualified small business stock was increased to 75% for stock acquired after February 17, 2009, and before September 28, 2010. The increase in the gain exclusion does not apply to the sale of empowerment-zone stock.

The gain exclusion was increased to 100% for qualified small business stock acquired after September 27, 2010, and before January 1, 2012. Thus, no regular tax or AMT is imposed on the sale of qualified stock held for more than five years.

New Law. An ATRA provision **extends** the 100% exclusion for **two years.** Thus, no regular tax or AMT is imposed on a noncorporate taxpayer upon the sale of any qualified small business stock that was acquired after September 27, 2010, and before January 1, 2014, and held for more than five years.

Research Credit

Old Law. A taxpayer may claim a research credit of 20% of the amount by which qualified research expenses[54] for a tax year exceed the taxpayer's base amount[55] for the year. Therefore, the research credit is generally available with respect to incremental increases in qualified research. An alternative simplified research credit may be claimed in lieu of this credit, using a 14% rate and a different base amount.

---

50. IRC §1202.
51. IRC §57(a)(7).
52. IRC §1202(b)(1).
53. IRC §1202(e)(3).
54. As defined in IRC §41(b).
55. As defined in IRC §41(c).

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

In order to qualify for the credit, the research must satisfy the following conditions.[56]

- The research must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component.
- Substantially all of the activities constitute elements of a process of experimentation for functional aspects, performance, reliability, or quality of a business component.
- The taxpayer must be able to elect to deduct the research expenditures as expenses that are not chargeable to a capital account under IRC §174.

Prior to the passage of ATRA, the research credit expired for amounts paid or incurred after December 31, 2011.

New Law. ATRA **extends** the research credit for **two years;** thus, it is available for amounts paid or incurred through December 31, 2013.

Differential Wage Credit

Old Law. An eligible small business[57] is allowed to take a 20% tax credit on the sum of eligible differential wage payments for each qualified employee for the tax year.[58] Differential wage payments are defined as the voluntary payments paid by employers to employees who are on active duty in the armed forces of the United States for more than 30 days. The differential wage payments represent all or a portion of the wages the individual would have received from the employer if the individual were performing services for the employer.[59]

The credit is available for differential wage payments made after June 17, 2008, and before January 1, 2012.

New Law. ATRA **extends** the availability of the credit for **two years.** Thus, it applies to amounts paid before January 1, 2014.

Indian Employment Tax Credit

Old Law. Employers are allowed a tax credit for the first $20,000 of qualified wages and qualified employee health insurance costs paid or incurred by the employer for certain employees. The credit is 20% of the amount of eligible employees' qualified wages and health insurance costs that exceeds the amount of such wages and health insurance costs incurred by the employer (or any predecessor) during 1993.[60] Qualified employees are those who satisfy all of the following conditions.[61]

- The employee is an enrolled member of an Indian tribe or the spouse of an enrolled member.
- The employee performs substantially all of the services for an employer within an Indian reservation.
- The employee has a principal place of abode on or near the reservation in which the services are performed.

The wage credit is available for wages paid or incurred in tax years beginning before January 1, 2012.

New Law. ATRA **extends** the credit for **two additional years,** through tax years beginning before January 1, 2014.

---

56. IRC §41(d).
57. As defined in IRC §45P(b)(3).
58. IRC §45P.
59. IRC §3401(h)(2).
60. IRC §45A(a).
61. IRC §45A(c).

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

2013 Workbook

Railroad Track Maintenance Credit

Old Law. A credit is allowed for 50% of qualified railroad track maintenance expenditures paid or incurred by eligible taxpayers during the tax year.[62] The credit applied to expenditures paid or incurred through December 31, 2011.

New Law. ATRA **extends** the credit for **two additional years.** Thus, it applies to qualified railroad track maintenance expenditures paid or incurred in tax years ending on or before December 31, 2013.

ENERGY-RELATED PROVISIONS

Credit for Energy-Efficient New Homes

Old Law. A credit is available to **eligible contractors** under IRC §45L for each qualified new energy-efficient home that is constructed and acquired by a person for use as a residence during the tax year. The credit applies to homes purchased prior to January 1, 2012.

To qualify as a new energy-efficient home, the home must be:

- A dwelling located in the United States;
- Substantially completed after August 8, 2005; and
- Certified to have a projected level of annual heating and cooling energy consumption that meets the standards for either a 30% or 50% reduction in energy usage compared to a comparable dwelling constructed in accordance with the standards of the 2003 International Energy Conservation Code.[63]

The credit is $1,000 for a new home that meets the 30% standard and $2,000 for a new home that meets the 50% standard.

New Law. ATRA **extends** the credit for **two years;** thus, it applies to homes purchased prior to January 1, 2014. Additionally, ATRA updates the home construction standard from the 2003 International Energy Conservation Code to the 2006 International Energy Conservation Code.

Energy-Efficient Appliance Credit

Old Law. A credit is allowed to the **manufacturer** of certain energy-efficient dishwashers, clothes washers, and refrigerators. The credits differ based on the specifications of the appliance and the year of manufacture.

The energy-efficient appliance credits expired as of December 31, 2011.

New Law. ATRA **extends** the credit for **two additional years.** Therefore, it applies to certain energy-efficient appliances manufactured in 2012 and 2013.

Nonbusiness Energy Property Credit

Old Law. IRC §25C provides a 10% credit to individuals for the purchase of qualified energy-efficiency improvements to the building envelope of existing homes. A **qualified energy-efficiency improvement** is any energy-efficiency building envelope component that satisfies all of the following conditions.

- It meets or exceeds the criteria established by the 2009 International Energy Conservation Code (or, in the case of windows, skylights, doors, and metal or asphalt roofs, meets the Energy Star program requirements).
- It is installed in or on a dwelling located in the United States and is owned and used by the taxpayer as their principal residence.
- The original use commences with the taxpayer.
- It reasonably can be expected to remain in use for at least five years.[64]

---

62. IRC §45G(a).

63. Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 112th Congress.* JCS-2-13 (Feb. 2013).

64. Ibid.

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

Building envelope components include the following.

- Insulation materials or systems that are specifically and primarily designed to reduce the heat loss or gain for a dwelling and that meet the criteria established by the 2009 International Energy Conservation Code
- Exterior windows (including skylights)
- Exterior doors
- Metal or asphalt roofs with appropriate pigmented coatings or cooling granules that are specifically and primarily designed to reduce the heat gain for a dwelling

Additionally, IRC §25C provides specified credits for the purchase of specific residential energy property originally placed in service by the taxpayer during the tax year. The **maximum aggregate credit** for a taxpayer for all tax years after December 31, 2005, is $500, of which no more than $200 may be attributable to expenditures on windows.[65] The allowable credits are as follows.

- $50 for each advanced main air circulating fan
- $150 for each qualified hot water boiler or natural gas, propane, or oil furnace
- $300 for each item of qualified energy-efficient building property (e.g., electric heat pump water heater; electric heat pump; central air conditioner; biomass fuel stove; and natural gas, propane, or oil water heater)[66]

The credit is available for property placed in service prior to January 1, 2012.

New Law. ATRA **extends** the credit for **two years,** through December 31, 2013.

Alternative Fuel Vehicle Refueling Property

Old Law. Taxpayers may claim a 30% credit for the cost of installing qualified clean-fuel vehicle refueling property. The property can be used in the taxpayer's trade or business or installed at the taxpayer's principal residence.[67] The credit may not exceed $30,000 per tax year per location for property used in a trade or business. For qualified refueling property installed at the taxpayer's principal residence, the credit may not exceed $1,000 per tax year per location.

Qualified refueling property is property (not including a building or its structural components) for the dispensing or storage of a clean-burning fuel or electricity into the fuel tank or battery of a motor vehicle. The dispensing or storage of the fuel or electricity must be at the point of delivery into the fuel tank or battery of the motor vehicle. The original use of the property must begin with the taxpayer.[68]

Credits for qualified refueling property used in a trade or business are part of the general business credit. They can be carried back for one year and forward for 20 years.[69]

The credit is available for property placed in service after December 31, 2005, and before January 1, 2012, except for hydrogen refueling property, which must be placed in service before January 1, 2015.

New Law. ATRA **extends** the credit for **two years** for all qualified fuel refueling property other than hydrogen refueling property, the credit for which continues under the prior law through 2014. For all other qualified fuel refueling property, the credit is available for property placed in service before January 1, 2014.

---

65. IRC §25C(b).

66. IRC §25C(d)(3).

67. IRC §30C.

68. Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 112th Congress*. JCS-2-13 (Feb. 2013).

69. Ibid.

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

Plug-in Electric Vehicle Credit

Old Law. A credit is available under IRC §30D for new qualified plug-in electric drive motor vehicles purchased after December 31, 2009. The maximum amount of the credit is $7,500, with a base amount of $2,500 and an additional $417 per kilowatt hour of battery capacity in excess of five kilowatt hours. Qualifying vehicles with at least four but less than five kilowatt hours of battery capacity are eligible for a $2,500 credit.

The following requirements apply to motor vehicles qualifying for this credit.

- The original use must begin with the taxpayer.
- It must be acquired by the taxpayer for use or lease and not for resale.
- It must be made by a manufacturer.
- It must have a gross-vehicle weight rating of less than 14,000 pounds.
- It must meet the standards of the Clean Air Act.
- It must be propelled to a significant extent by an electric motor that draws electricity from a rechargeable battery with a capacity of at least four kilowatt hours.

The term "motor vehicle" means any vehicle that is manufactured primarily for use on public streets, roads, and highways. It must have at least four wheels.[70]

The credit is phased out after **200,000** new qualified plug-in electric vehicles are sold by a manufacturer after December 31, 2009. This credit applies to units sold for use in the United States only.

New Law. ATRA expands the plug-in electric vehicle credit to include electric motorcycles and 3-wheeled vehicles **acquired during 2012 and 2013.** The credit allowed for 2- and 3-wheeled vehicles is the lesser of the following.[71]

- 10% of the cost of the qualified 2- or 3-wheeled plug-in electric vehicle
- $2,500

The following requirements apply to 2- or 3-wheeled vehicles qualifying for the credit.[72]

- It has two or three wheels.
- It is manufactured primarily for use on public streets, roads, and highways.
- It is capable of achieving a speed of at least 45 miles per hour.
- It is acquired after December 31, 2011, and before January 1, 2014.
- The original use commences with the taxpayer.
- It is acquired for use or lease by the taxpayer and not for resale.
- It is made by a manufacturer.
- It has a gross vehicle weight of less than 14,000 pounds.
- It has a battery with a capacity of not less than 2.5 kilowatt hours that is capable of being recharged from an external source of electricity.

---

70. IRC §30D(d)(2).
71. IRC §30D(g)(2).
72. IRC §30D(g)(3).

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

Biodiesel and Renewable Diesel Credits

Old Law. An income tax credit is allowed for biodiesel and renewable diesel fuels **sold or used in the taxpayer's trade or business** on or before December 31, 2011. Three biodiesel fuels credits are available under IRC §40A.

1. The **biodiesel mixture credit** is $1.00 per gallon of biodiesel used by the taxpayer in the production of a qualified biodiesel mixture. The term "qualified biodiesel mixture" means a mixture of biodiesel and diesel fuel, which is:
    a. Sold by the taxpayer producing the mixture to any person for use as a fuel, or
    b. Used as a fuel by the taxpayer producing the mixture.[73]
2. The **biodiesel credit** is $1.00 per gallon of biodiesel that is not in a mixture with diesel fuel and that:
    a. Is used by the taxpayer as a fuel in a trade or business during the tax year, or
    b. Is sold by the taxpayer at retail to a person and placed in the fuel tank of that person's vehicle.
3. The **small agri-biodiesel producer credit** is $0.10 per gallon for up to 15 million gallons of agri-biodiesel fuel produced by small producers.

A **biodiesel mixtures excise tax credit** is also available under IRC §6426(c). The excise tax credit is $1.00 for each gallon of biodiesel fuel used by the taxpayer in the production of a biodiesel mixture for sale or use in the taxpayer's trade or business.

New Law. ATRA **extends** the income tax credits and excise tax credit for **two years,** through December 31, 2013.

Alternative Fuels Credits

Old Law. Two alternative fuel excise tax credits are provided by the Code: the alternative fuel credit[74] and the alternative fuel mixture credit.[75] Additionally, taxpayers can obtain a cash payment (outlay payment) under IRC §6427(e) for the amount of the alternative fuel credit and alternative fuel mixture credit that exceeds the applicable excise tax liability. These credits and outlay payment provisions generally expired on December 31, 2011. The credits and outlay payment provisions with respect to liquefied hydrogen expire on September 30, 2014.

New Law. The alternative fuel excise tax credits (for nonhydrogen fuels) are **extended** for **two additional years,** through December 31, 2013. The outlay payment provision for the alternative fuel credit was also extended through December 31, 2013. However, the outlay payment provision for the alternative fuel mixture credit was not extended.

Renewable Electricity Production Credit

Old Law. Under IRC §45, an income tax credit is available for the production of electricity from qualified energy resources at qualified facilities. **Qualified energy resources** include wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy.[76] **Qualified facilities** include wind facilities, closed-loop biomass facilities, open-loop biomass facilities, geothermal or solar energy facilities, small irrigation power facilities, landfill gas facilities, trash facilities, refined coal production facilities, qualified hydropower facilities, Indian coal production facilities, and marine and hydrokinetic renewable energy facilities.[77]

---

73. IRC §40A(b)(1).
74. IRC §6426(d).
75. IRC §6426(e).
76. Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 112th Congress*. JCS-2-13 (Feb. 2013).
77. IRC §45(d).

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.

The credit is generally available for electricity produced during the first 10 years after the facility is placed in service. Wind facilities had to be **placed in service** by December 31, 2012, to qualify for the 10-year credit. Most of the other types of facilities were required to be placed in service by December 31, 2013.

Under IRC §48, a taxpayer can elect to treat certain property that is part of a qualified renewable electricity production facility as energy property eligible for a 30% **investment credit.** Qualified facilities for this purpose are those that are otherwise eligible for the renewable electricity production credit for which no §45 credit has been allowed. To qualify for the investment credit, the facilities must be placed in service by the same dates as those applicable to the production credit.

New Law. ATRA **extends** the wind credits (production and investment) **for one year,** through December 31, 2013. Additionally, the expiration date for most renewable power facilities (including wind facilities) is modified such that qualified facilities or property are eligible for either the renewable electricity production credit or the investment credit if the **construction of the facilities or property begins** prior to January 1, 2014.[78]

Note. Under prior law, facilities had to be placed in service by a certain date to qualify for the credit. Under the ATRA modifications, construction only has to begin by December 31, 2013, to qualify for either the production credit or the investment credit.

ATRA also modifies the definition of municipal solid waste for purposes of the credit to exclude commonly recycled paper that has been segregated from such waste.

Cellulosic Biofuel Producer Credit

Old Law. The cellulosic biofuel producer credit is a nonrefundable income tax credit for each gallon of qualified cellulosic biofuel production for the tax year. The credit is generally $1.01 per gallon and was available through December 31, 2012.

New Law. ATRA **extends** the credit for cellulosic biofuel for **one additional year,** through December 31, 2013. ATRA also made a technical correction by specifying that the cellulosic biofuel producer credit may only be carried forward three years after the termination of the credit.

78. Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 112th Congress.* JCS-2-13 (Feb. 2013).

Copyrighted by the Board of Trustees of the University of Illinois.
This information was correct when originally published. It has not been updated for any subsequent law changes.