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The PATH Act: What Tax Lawyers Need To Know

By Robert W. Wood

After years of deadlock, the PATH Act — Protecting Americans from Tax Hikes — seemed to slide easily through Congress and was signed by President Barack Obama. There is something for everyone in this massive and surprising tax law. The bill contains a number of tax breaks for low income earners and businesses.

And while high income earners may feel left out, the business incentives in the law are huge. Lawyers in law firms and in-house should know the basics not only for their clients, but also for themselves. That new phone system, computer system, copy machine, wages for new employees, and even a car — or private plane — may have just gotten less expensive.

One of the most important accomplishments of the law is to restore some predictability to taxes. Congress can always change its mind and change the law. Still, that risk is different from the odd year-by-year dance we got used to tolerating. For years, we have had year-end band aids that allow one more year of a particular tax benefit.

Often, these year-end 'one more year' add-ons come during the holidays, after it is already too late in the year to do any effective planning. In large part, the new law does away with that inefficiency. Rather than year-by-year last minute deals, dozens of 'extenders' were made permanent parts of the tax code. Some more were extended until the end of 2016, and some until the end of 2019. Here are five key rules:

Section 179 Expensing

Section 179 of the Tax Code allows small businesses to immediately deduct up to $500,000 of investments. That means deduct, rather than capitalize and depreciate over time. The law had dropped back to $25,000 a year, so this $500,000 allowance is huge. The act makes it permanent and even indexes it for inflation.

Deducting is easier and better than capitalizing and depreciating over time. Capitalizing involves spending money now and capitalizing the asset with a 5 or 7 year life. You just get little deductions each year. Now, you can write it off!

Bonus Depreciation

What if your business makes capital expenditures beyond the $500,000 limit? There's bonus depreciation, and this one is big too. Although the new tax law didn't make it permanent, it will be here for another 5 years. So there is still time to take advantage of it.

Bonus depreciation allows businesses to immediately deduct 50 percent of some investment costs. Even many big expenditures qualify. Unfortunately, the act only extends bonus depreciation until the end of 2019, rather than making it permanent. However, with the current election cycle and what Presidential candidates are saying about taxes, there is talk that this may not expire in 2019 after all? We'll see.

Research & Experimentation

This one is huge. Called R&E or R&D, it is worth billions. In fact, it is the single most expensive provision in the act. It makes the research and experimentation credit permanent.

The R&E credit allows businesses that engage in research activities to lower their taxes. If a business can properly qualify $100 of wages or other costs as for covered research, the business saves $20 on it taxes. It is an incredible deal.

However, it has been volatile in the extreme. Since 1981, the credit has expired and been renewed a whopping 16 times! But now, the credit is permanent, and the usual 20 percent credit — meaning tax credit, not tax deduction — is huge.

The number of businesses depending on this credit is likely to increase. Up until now, the sheer temporariness of the credit has made many companies and many tax preparers gun shy. That should change now.

Cadillac Tax Delay

One of the most dreaded parts of a dreaded law, the Cadillac tax was supposed to pay for much of the Affordable Care Act. It became quite political too, with some claiming that the administration was underhanded and that the tax was a gotcha that was deceptively packaged.

The U.S. Supreme Court upheld the ACA as a tax law, and it contains many taxes. When the ACA was enacted in 2010, the Cadillac tax was buried, not applying until 2018. An already overburdened IRS has to administer it.

Like all of the ACA, the Cadillac tax is enormously complex and nuanced. Of all the act's taxes, none is more onerous than the Cadillac tax. It is a big tax, a whopping 40 percent on top of all other federal taxes. What's more, it is an excise tax, one of the most dreaded kinds of taxes there is.

It is a rifle shot tax that is supposed to discourage high cost plans. But it now looks likely to apply to more people and to more plans — most everyone drives a Cadillac. In that sense, the tax is a kind of rifle shot that has turned into a shotgun blast. A survey by the International Foundation of Employee Benefit Plans reveals that 62 percent of companies facing a 40 percent Cadillac tax hit are changing their coverage to avoid it.

Conversely, only 2.5 percent of companies say they will pay it. To avoid it, companies are changing to higher deductible plans, reducing benefits, shifting more costs to employees, or even dropping high-cost plans altogether. Most people seem to agree that the Cadillac tax is a lemon. But now, it is delayed from its scheduled 2018 start date until 2020. Maybe that will turn into a permanent delay?

Medical Device Tax Delay

The ACA also included a new excise tax on medical devices, and it too has been quite controversial. The PATH Act delays the medical device tax for two years, until 2018.

Lawyers should familiarize themselves with the key provisions of the PATH Act, not only to advise their clients, but also to be aware of how the act may affect their own taxes.

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