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The so-named "American Taxpayer Relief Act," now signed by the President after having been passed in the wee hours by the Senate on January 1, 2013, and later that day by the House, may pull the country back from a self-created fiscal/political ditch, but leaves the country at the edge of a fiscal cliff with spending cut issues, debt ceiling issues and undoubtedly more tax issues to be dealt with before March 1, 2013.

Overview. This legislation increases the tax on individual taxpayers with taxable income above specified thresholds (generally stated to be $400,000 or $450,000). Note, limited liability companies are now the predominate form of closely held businesses and a source of much of the US job growth. LLC income that is retained by the business nevertheless is included in the owner’s taxable income subject to this tax increase.

The legislation also increases the capital gains tax rate for such taxpayers phases out personal exemptions and phases down itemized deductions for taxpayers with a lower adjusted gross income threshold of $300,000/$250,000, retains the $5,000,000 estate and gift tax exclusion but raises the tax rate to 40%. provides a permanent, indexed and higher alternative minimum tax exemption, and has a number of “extenders” for provisions that generally expired at the end of 2011 to carry them through 2013. IRA distributions to charity in the month of January 2013 can be treated as if made in 2012. A few of the many extenders are:

- The option to deduct state and local sales tax in lieu of income tax remains for 2012 and 2013
- 50% bonus depreciation for 2012 and 2013
- R&D credit for 2012 and 2013
- Expensing of up to $500,000 of certain property is permitted for 2012 and 2013
- Exclusion for forgiven home mortgage debt in 2013

The legislation did not postpone the 2% of wages increase in the employee portion of the social security payroll taxes so all taxpayers regardless of income level will feel some pain (commentators estimate an average of $700 per taxpayer).

In addition to the tax provisions, there are many Medicare and other health extensions as well as an extension of the emergency unemployment compensation program and related benefits. Congress will not receive a cost of living increase in fiscal year 2013 as a result of this legislation.

Surprisingly, there is an amendment to the National Defense Authorization Act for Fiscal Year 2013 dealing with certain arms control obligations and Russia.

Finally, the 2013 sequestering called for by the Balanced Budget and Emergency Deficit Control Act of 1985 is deferred from January 2, 2013 to March 1, 2013. In accordance with the President’s remarks at 1:45 Eastern Standard Time on December 31, 2012, it is anticipated there will be further tax law changes accompanying any spending cuts.
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I. GENERAL EXTENSIONS
(Extension and Modification of 2001 and 2003 Tax Relief, Extension of 2009 Tax Relief and Permanent Alternative Minimum Tax Relief)

A. Individual Income Tax Brackets

1. The “Bush Tax Cut” brackets were made permanent for individuals with taxable income less than:
   a) Married (filing jointly) $450,000
   b) Head of Household $425,000
   c) Single $400,000
   d) Married (filing separately) $225,000

The above thresholds are indexed for CPI inflation occurring after 2012 for tax years beginning after 2013.

A 39.6% bracket applies to taxable income above the thresholds above.

B. Capital Gains and Dividends

1. 15% or lesser of adjusted net capital gain (or taxable income) that would be taxed at a rate below 39.6% over the amount that would be subject to capital gains rate of 5% (taxable income bracket with capital gains below 25% rate);
2. 20% for capital gain in excess of “a” above;
3. AMT and capital gains utilizes the 15% and 20% brackets
4. In the extenders discussed below, the gain from certain small business stock (as defined in Section 1202 of the Code) if acquired in 2012 and 2013 if held for five years or more is entitled to 100% exclusion from gross income upon its sale.

Note: The 3.8% non-deductible “Medicare contribution” excise tax on investment income was not modified and still applies as otherwise scheduled. This applies when adjusted gross income exceeds $250,000 for married filing jointly, $125,000 for married filing separately and $200,000 for all others.
C. Phase-Out of Personal Exemptions and Itemized Deductions (Extension of Clinton Era Caps and Phase Out)

1. Itemized Deductions - can be reduced by up to 80%
   a) Itemized deductions are reduced by 3% of excess of adjusted gross income over:
      (1) Married (filing jointly) $300,000
      (2) Head of Household $275,000
      (3) Single $250,000
      (4) Married (filing separately) $150,000

   The above thresholds are indexed for CPI inflation occurring after 2012 for tax years beginning after 2013.

2. Personal exemption
   a) The personal exemption amounts ($2,000 per exemption) are phased out 2 percentage points for each $2,500 (or fraction thereof) that the taxpayer’s adjusted gross income exceeds:
      (1) Married (filing jointly) $300,000
      (2) Head of Household $275,000
      (3) Single $250,000
      (4) Married (filing separately) $150,000

   The above thresholds are indexed for CPI inflation occurring after 2012 for tax years beginning after 2013.

Observation: The phase out of itemized deductions and personal exemptions may impact the taxpayer’s tax bracket as taxable income is increased.


1. The estate tax brackets were modified. The estate tax rate for estates was modified with marginal bracket for estates:
   a) Over $500,000 but not over $750,000 of 37%
   b) Over $750,000 but not over $1 million of 39%
   c) Over $1 million of 40%

E. AMT “Relief” (was impacting senior federal employees)

1. The exemption amount for individuals was permanently raised to
$78,500 for individuals married filing jointly (or surviving spouse); $50,600 for single and not surviving spouse; $39,250 for married filing separately. These amounts are indexed for CPI increases after 2012, using 2011 as the base (not 2012). This means there will be a CPI adjustment for 2013 for the AMT exemption.

2. Non-refundable tax credits may be used up to the amount that does not exceed the sum of the taxpayer’s regular tax liability (reduced for foreign tax credit) and the AMT. This provision applies to a number of credits and a carry-forward appears to be allowed for a number of such credits to the extent they cannot be used.

F. Extension of Certain Credits for Five Years (Tax Years Beginning Before 2018)

1. American Opportunity Tax Credit
2. Child Tax Credit
3. Refundable credits (or advance payments) made to individuals under Title 28 (income tax provisions) received after December 31, 2012, are not taken into account for means testing for any Federal program or state or local program financed in whole or in part with Federal Funds.

G. Other

1. Amounts in applicable retirement plans which include a qualified Roth contribution program may be directed by the individual to be transferred after December 31, 2012, to the Roth account and treated as a qualified rollover, and the plan shall not be treated as violating various otherwise applicable rules.

2. The budgetary effects of this legislation will not count in any PAYGO scorecards.
II. INDIVIDUAL TAX EXTENDERS
(Generally retroactive coverage for 2012 and a 1-year extension.)

Sec. 201. Extension of deduction for certain expenses of elementary and secondary school teachers.
- For 2012 and 2013 not to exceed $250 per year
- Deduction to determine adjusted gross income

- After December 31, 2012, and before January 1, 2014

Sec. 203. Extension of parity for exclusion from income for employer-provided mass transit and parking benefits.
- Up to $175 per month for employer provided mass transit and parking for 2012 and 2013
- Afterwards it falls back to $100 per month

Sec. 204. Extension of mortgage insurance premiums treated as qualified residence interest.
- For 2012 and 2013

Sec. 205. Extension of deduction of State and local general sales taxes.
- As an optional alternative to the deduction of state and local income tax for tax years beginning before January 1, 2014

Sec. 206. Extension of special rule for contributions of capital gain real property made for conservation purposes.
- Including conservation easements for tax years beginning in 2012 and 2013
- An extension passed in 2013 to encourage individual giving in tax years beginning in 2012 lacks the benefit of inducing the desired behavior.
- Fortunately for those who gambled that the law would be extended, it appears to be the case. Those desiring to do so can safely plan for 2013.

Sec. 207. Extension of above-the-line deduction for qualified tuition and related expenses.
- Used to determine adjusted gross income for qualified tuition and related expenses for taxpayers with adjusted gross income of less than $160,000 for tax years beginning before January 1, 2014
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- The deduction is up to $4,000 for taxpayers whose AGI does not exceed $65,000 ($130,000 if joint return) and $2,000 for taxpayers whose AGI exceeds that threshold but does not exceed $80,000 ($160,000 if joint return).

Sec. 208. Extension of tax-free distributions from individual retirement plans for charitable purposes.

- Distributions made after December 31, 2012, and before February 1, 2013, can be elected by the taxpayer as having been made on December 31, 2012.
- Distributions after November 30, 2012, and before January 1, 2013, may be treated as a qualified charitable distribution to the extent of the portion transferred in cash to qualified charity before February 1, 2013.

Sec. 209. Improve and make permanent the provision authorizing the Internal Revenue Service to disclose certain return and return information to certain prison officials.
III. BUSINESS TAX EXTENDERS
(Generally retroactive coverage for 2012 and extension for 2013.)

Sec. 301. Extension and modification of research credit.
- The research and development tax credit is extended for amounts paid or incurred prior to January 1, 2014. This means that 2012 and 2013 research and development expenses are eligible for the credit.
- For taxable years beginning after December 31, 2011, a new rule for partial inclusion of pre-acquisition qualified research and development expenses and gross receipts for the year of acquisition of a “major portion” of either a trade or business or a separate unit of a trade or business is added to the Code.
- The qualified research and development expenses of the acquired business is included in future measurement periods. The predecessor may adjust its history for the qualified research and development expenses and gross receipts attributable to the business sold.

Sec. 302. Extension of temporary minimum low-income tax credit rate for non-federally subsidized new buildings.
- Extends temporary minimum low-income tax credit rate of not less than 9% for non-federally subsidized new buildings with respect to housing credit dollar amount allocations made before January 1, 2014.
- Previously required that the building be placed in service before January 1, 2013 but now the place in service requirement is repealed and the test is credit dollar allocations before January 1, 2014.

Sec. 303. Extension of housing allowance exclusion for determining area median gross income for qualified residential rental project exempt facility bonds.

Sec. 304. Extension of Indian employment tax credit.
- Extends to wages and health insurance costs for an employer for tax years beginning before December 31, 2013.

Sec. 305. Extension of new markets tax credit.
- Provides for $3.5 billion of credit for 2012 and 2013 calendar years.

Sec. 306. Extension of railroad track maintenance credit.
- Extends the credit for qualified railroad maintenance expenditures to include expenditures paid or incurred in taxable years beginning after December 31, 2011, and before January 1, 2014.
Sec. 307. **Extension of mine rescue team training credit.**
- Extends credit for amount paid or incurred up to $10,000 per qualified mine rescue team employee in tax years beginning after December 31, 2011, and prior to December 31, 2013, with respect to training program costs
- Includes wages of such employee while attending such training

Sec. 308. **Extension of employer wage credit for employees who are active duty members of the uniformed services.**
- For employees who are active duty members of the uniformed services for payments made after December 31, 2011, and through December 31, 2013

Sec. 309. **Extension of work opportunity tax credit.**
- For hiring targeted groups with respect to individuals who begin work for the employer after December 31, 2011, and before January 1, 2014

Sec. 310. **Extension of qualified zone academy bonds.**
- Applies to a qualified zone academy established by an eligible local education agency with a national zone academy bond limitation of $1.4 billion for each calendar year for 2012 and 2013
- Applies to obligations issued after December 31, 2011

Sec. 311. **Extension of 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements.**
- For applicable improvements placed in service after December 31, 2011, and before January 1, 2014

Sec. 312. **Extension of 7-year recovery period for motorsports entertainment complexes.**
- For applicable complexes placed in service after December 31, 2011, and on or before December 31, 2013

Sec. 313. **Extension of accelerated depreciation for business property on an Indian reservation.**
- For applicable property placed in service after December 31, 2011, and on or before December 31, 2013
Sec. 314. **Extension of enhanced charitable deduction for contributions of food inventory.**
- For contributions made after December 31, 2011, and on or before December 31, 2013

Sec. 315. **Extension of increased expensing limitations and treatment of certain real property as section 179 property.**
- Extends increased expensing limitation of $500,000 for taxable years beginning in 2012 and 2013 [2012 had a limitation of $125,000 indexed for inflation and 2013 had a limitation of $25,000 not indexed for inflation]
- The limitation drops to $25,000 for tax years beginning after December 31, 2013. This increased limitation, however, is reduced to the extent the 179 property placed in service exceeds $2 million for tax years beginning in 2012 or 2013 with such amount dropping to $200,000 in subsequent years.
- At the taxpayer’s election, up to $250,000 of the cost of certain real property (qualified leasehold improvement, restaurant and retail improvement property) may be expensed for taxable years beginning in 2012 or 2013. A carryover from 2010, 2011 and 2012 through tax years beginning in 2013 is permitted.

Sec. 316. **Extension of election to expense mine safety equipment.**
- Applies to 50% of the cost of advanced mine safety equipment placed in service after December 31, 2011, and before January 1, 2014

Sec. 317. **Extension of special expensing rules for certain film and television productions.**
- Extends special expensing rules (generally up to $15 million but up to $20 million if significant cost incurred in a low income community, distressed county or certain isolated area of distress) for certain film and television productions commencing after December 31, 2011, and before January 1, 2014

Sec. 318. **Extension of deduction allowable with respect to income attributable to domestic production activities in Puerto Rico.**
- Section 199 of the Code provides for a deduction of an amount equal to 9% of the lesser of qualified production activities income of the taxpayer or taxable income (before application of Section 199). Such deduction cannot exceed 50% of W-2 wages of the taxpayer.
- The legislation extends the definition of United States for determining domestic production to Puerto Rico for taxpayers meeting certain requirements for the first 8 taxable years (was previously 6 years) of the
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taxpayer beginning after December 31, 2005, and before January 1, 2014 (was January 1, 2012).

- The provisions apply to tax years beginning after December 31, 2011.

Sec. 319. Extension of modification of tax treatment of certain payments to controlling exempt organizations.

- Extends partial exclusion from UBTI for payments to controlling tax exempt organizations paid or incurred prior to December 31, 2013 (was December 31, 2011)
- To the extent the payment was pursuant to a binding written contract in effect in 1997, including renewals, would be deductible as an arms’ length payment, such amount paid by a controlled for profit entity to a controlling non-profit entity.

Sec. 320. Extension of treatment of certain dividends of regulated investment companies.

- Certain interest-dividends from Regulated Investment Companies (RIC) to non-resident aliens are not subject to a 30% tax with respect to payments for taxable years ending before December 31, 2013 (was December 31, 2011). The author expects that many non-residents ceased to hold RIC investments before tax years beginning in 2012.

Sec. 321. Extension of RIC qualified investment entity treatment under FIRPTA.

- The exclusion of a non-resident alien from U.S. tax of a domestically controlled qualified investment entity included Regulated Investment Companies which is a U.S. real property holding corporation through December 31, 2011.
- The legislation extends the December 31, 2011 date through December 31, 2013, and has a retroactive date of January 1, 2012.
- However, the amendment does not apply to taxes withheld on distributions after December 31, 2011 and before the date of enactment (when President Obama signs the law) and the withholding party is not liable to anyone as a result of such withholding and remittance to the Treasury. It appears that the non-resident alien will have to enter the U.S. tax system and file a claim for refund.

Sec. 322. Extension of subpart F exception for active financing income.

For active financing and insurance income applied for tax years beginning before January 1, 2012, the legislation extends the date to January 1, 2014.
Sec. 323. **Extension of look-thru treatment of payments between related controlled foreign corporations under foreign personal holding company rules.**
- This look-through applied to foreign corporation’s tax years beginning before January 1, 2012. The date is changed to January 1, 2014.

Sec. 324. **Extension of temporary exclusion of 100 percent of gain on certain small business stock.**
- Extends the acquisition of such stock until January 1, 2014, and provides that Section 1223 of the Code is applied to determine when stock is deemed to begin to be held.

Sec. 325. **Extension of basis adjustment to stock of S corporations making charitable contributions of property.**
- Extends adjusting the basis of an S corporation’s stock for charitable contributions of property only by the adjusted basis of the property (i.e., not for the fair market value of the property)
- Applicable to tax years beginning before January 1, 2014
- This relief provision prior to this amendment was not available for tax years beginning after December 31, 2011.

Sec. 326. **Extension of reduction in S-corporation recognition period for built-in gains tax.**
- Corporations that were previously C corporations and for which an S election is made, will normally be required to recognize the “built-in” gain in the value of such corporations’ assets if sold within 10 years of the S election.
- This period was temporarily shortened to 7 years for 2009 and 2010 and for 5 years for 2011. The five year period is extended for 2012 and 2013 for recognition of built-in gain in such years.
- In addition, for installment sales by the S corporation made in taxable years beginning after December 31, 2011, for purposes of the built-in gain rule, all gain shall be deemed to be recognized in the year of sale.

Sec. 327. **Extension of empowerment zone tax incentives.**
- Empowerment zones had various special incentives for economic development. Such zones by statute terminated on the earlier of the date designated in the nomination of the area as an empowerment zone or December 31, 2011.
The legislation provides for a new termination date of December 31, 2013, and provides that zones that expired by their own terms on December 31, 2011, may be extended through December 31, 2013.

60% of the capital gain on qualified small business stock of a qualified business entity (requires operations in empowerment zone) during substantially all of the taxpayer’s holding period shall be excluded to the extent such gain is attributable to periods ending prior to December 31, 2018.

Sec. 328. Extension of tax-exempt financing for New York Liberty Zone.
- Extends to bonds from before January 1, 2012, to before January 1, 2014

Sec. 329. Extension of temporary increase in limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands.

Sec. 330. Modification and extension of American Samoa economic development credit.

Sec. 331. Extension and modification of bonus depreciation.
- Extension and modification of 50% Bonus Depreciation to be applicable to qualified property:
  - Depreciable life of less than 20 years, computer software, water utility property or qualified leasehold improvement property placed in service prior to January 1, 2014, or in the case of certain longer production periods or certain aircraft, January 1, 2015
  - A corporation may elect to accelerate the AMT credit in lieu of bonus depreciation for eligible qualified property with respect to adjusted basis attributable to manufacture, construction or production after December 31, 2010, and before January 1, 2014.
- Because the election to accelerate the AMT credit in lieu of bonus required certain elections, and there have now been 3 extensions, the statute provides for separate elections for property in each round of extensions including property subject to this round 3 extension.
IV. ENERGY TAX EXTENDERS

Sec. 401. Extension of credit for energy-efficient existing homes.
- The period for making residential qualified energy efficiency improvements for principal residence and receiving a 10% credit of up to $500 for all tax years ending after December 31, 2005, is extended for property placed in service until December 31, 2013.

Sec. 402. Extension of credit for alternative fuel vehicle refueling property.
- The period for placing in service qualified alternative fuel vehicle refueling property by a taxpayer is extended until December 31, 2013, for such property placed in service after December 31, 2011.

Sec. 403. Extension of credit for 2- or 3-wheeled plug-in electric vehicles.
- Although labeled as an extender, the qualified plug-in electric drive motor vehicle credit is expanded to cover two- and three-wheel plug-in electric vehicles. The credit is the lesser of 10% of the cost or $2,500.
- Such vehicle must be acquired after December 31, 2011, and before January 1, 2014.

Sec. 404. Extension and modification of cellulosic biofuel producer credit.
- The credit for cellulosic biofuel producer credit is extended and modified with respect to qualified cellulosic biofuel production after December 31, 2008, and before January 1, 2014.
- Algae is added as a qualified feedstock with special provisions. The provision applies to fuels sold or used after the date of enactment.

Sec. 405. Extension of incentives for biodiesel and renewable diesel.
- Applies to sales or uses until December 31, 2013

Sec. 406. Extension of production credit for Indian coal facilities placed in service before 2009.
- The production credit for American Indian coal facilities placed in service before 2009 is extended from 7 years to 8 years. The first year was 2005, so 8 years carries the credit incentive out through 2013.

Sec. 407. Extension and modification of credits with respect to facilities producing energy from certain renewable resources.
- Includes wind facilities, closed-loop and open-loop biomass facilities, geothermal or solar energy facilities, small irrigation power facilities, landfill gas facilities, refined coal production facilities, qualified
hydropower facilities, American Indian coal production facilities and marine and hydrokinetic renewable energy facilities

- Placed-in-service, modification, efficiency improvement or addition-to-capacity dates were extended for many of the facilities and converted to construction beginning dates (from placed in service) before January 1, 2014.

**Sec. 408. Extension of credit for energy-efficient new homes.**

- Extended through December 31, 2013
- The standard is changed to 2006 International Energy Conservation Code. The credit is $1,000 to $2,000, depending on the dwelling unit and level of reduced heating and cooling energy consumption.

**Sec. 409. Extension of credit for energy-efficient appliances.**

- The credit for energy efficient appliances is extended to include appliances acquired in 2012 and 2013, but certain dishwashers and top loading clothes washers are not extended.

**Sec. 410. Extension and modification of special allowance for cellulosic biofuel plant property.**

- 50% bonus depreciation is extended to cellulosic biofuel plant property placed in service before January 1, 2014.
- Algae is included as qualified feedstock for purposes of bonus depreciation for biofuel plant property.

**Sec. 411. Extension of special rule for sales or dispositions to implement FERC or State electric restructuring policy for qualified electric utilities.**

- Optional 8-year recognition period for sales or disposition of qualifying electric transmission transaction to implement Federal Energy Regulatory Commission or State electric restructuring policy will apply to dispositions after December 31, 2011, and before January 1, 2014.

**Sec. 412. Extension of alternative fuels excise tax credits.**

- The alternative fuels excise tax credit was extended through December 31, 2013.

For more information, please contact Leigh Griffith or any member of Waller’s Tax practice at 800-487-6380.