



J O B C R E A T I O N A N D
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Job Creation and Worker Assistance Act of 2002

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Introduction

Just ahead of the six-month anniversary of the terrorist attacks of September 11, 2001, the U.S. Congress passed the *Job Creation and Worker Assistance Act of 2002* (Pub. L. No. 107-147),² providing more rapid depreciation deductions, greater opportunities to use net operating losses, extended unemployment benefits, special tax relief for New York reconstruction, and other tax law changes. The Act became law March 9, 2002, when President Bush signed it.

The major business provisions of the Act include a “bonus” depreciation allowance under which 30 percent of the cost of certain new property is deductible in the year the property is placed in service, net operating loss carrybacks for five years rather than two, and extension of expiring provisions -- most actually expired in December 2001 -- for two years (five years in the case of the active financing income exception under Subpart F).

Most provisions are effective for a limited period, consistent with the Act’s original rationale that the economy needed a short-term boost that would not drain the fisc in the long term. Democrats and Republicans spent five months debating the terms of the stimulus bill. In the end, they agreed to a bill that cost \$42 billion³ over 10 years.

Both parties started with ambitious agenda but were forced to give up favored items. Among the jettisoned provisions: increased small business expensing deductions, acceleration of the timetable for the marginal income tax rate cuts enacted in 2001, retroactive repeal of the corporate alternative minimum tax, refunds for those who did not receive last summer’s advance payment checks, and assistance to help laid-off workers retain health insurance. Other issues, such as the growing effect of the individual alternative minimum tax on the middle class and the sunset of last summer’s tax legislation, remain for another day.

A description of the Act’s provisions follows.

² For statutory language of the “Act,” see the Library of Congress Web site: <http://thomas.loc.gov/>.

³ \$ = USD.

Provisions Affecting Businesses

Bonus Depreciation

The Act allows taxpayers to take a “bonus” depreciation deduction for certain qualified property if its original use commences with the taxpayer after September 10, 2001, and it is acquired by the taxpayer after September 10, 2001 and before September 11, 2004. The “bonus” deduction is equal to 30 percent of the basis of the qualified property. The remaining 70 percent of the basis of the qualified property will be depreciated under the usual rules for depreciating such property. For property for which the 30 percent bonus deduction is allowed, there is no depreciation adjustment required in computing alternative minimum tax (AMT) (*i.e.*, the depreciation deduction, including the 30 percent bonus deduction, is the same for regular tax and for AMT).

Qualified property includes:

- MACRS property with a recovery period of 20 years or less
- Computer software (other than computer software that must be amortized under section 197)
- Water utility property (as defined in section 168(e)(5))
- Qualified leasehold improvement property

Qualified leasehold improvement property is defined as improvements that are made:

- To an interior portion of a building that is nonresidential real property
- Under or pursuant to a lease
- By the lessee (or any sublessee) or the lessor of those premises
- To premises that will be occupied exclusively by the lessee (or any sublessee) of those premises
- Placed in service more than three years after the date the building was first placed in service

A commitment to enter into a lease will be treated as a lease for these purposes. Generally, leases between members of an affiliated group of corporations or between certain other parties that are under 80-percent common control will not be so treated.

Improvements do not qualify if they:

- Enlarge the building
- Are for elevators or escalators
- Are to structural components benefiting a common area
- Are to the internal structural framework of the building

Property is not eligible for the bonus deduction if the taxpayer is required to depreciate it using the straight-line method and the longer recovery periods of the Alternative Depreciation System (ADS). For example, property predominantly used outside the

United States, certain property leased to a tax-exempt entity, or property with 50 percent or less business use is not eligible. Property remains eligible for the bonus deduction, however, if the taxpayer elects to use ADS.

Also, New York Liberty Zone leasehold improvement property does not qualify for bonus depreciation.

Example

Depreciation deductions that a taxpayer would take each tax year on an investment of \$1,000 in qualified property, under current law and under the Act, for 5-year property and 7-year property, assuming a half-year convention applies, are as follows:

5-Year Property

Tax Year	1	2	3	4	5	6
Prior Law	200	320	192	115	115	58
The Act	440	224	134	81	81	40

7-Year Property

Tax Year	1	2	3	4	5	6	7	8
Prior Law	143	245	175	125	89	89	89	45
The Act	400	171	122	87	63	63	63	31

KPMG Observation

In Notices 2001-70⁴ and 2001-74,⁵ the IRS announced that it will allow taxpayers to elect to compute depreciation on property placed in service in a tax year whose third or fourth quarter includes September 11, 2001, without regard to the midquarter convention. The midquarter convention generally applies if more than 40 percent of the tangible personal property the taxpayer places in service for the tax year is placed in service in the last three months. If the midquarter convention applies, the taxpayer in most cases will be allowed less first-year depreciation than under the half-year convention. Taxpayers that make this election will use the half-year convention.

Special Rules

A special rule preserves the availability of the bonus deduction in sale and leaseback situations. Property originally placed in service after September 10, 2001, that is sold and leased back will be eligible for the bonus deduction.

⁴ 2001-45 I.R.B. 437.

⁵ 2001-49 I.R.B. 551.

Self-constructed qualified property may be eligible for the bonus deduction if the taxpayer begins its manufacture, construction, or production after September 10, 2001, and before September 11, 2004.

A taxpayer may elect not to take bonus depreciation on a class-by-class basis; for example, an “election out” may be made for all 5-year property, or all 7-year property, but not on a property-by-property basis.

Prior law limited the first-year depreciation deduction for certain “luxury” automobiles to \$3,060 (in 2001 and 2002), and limited deductions in later years. The Act raises the first-year limitation by \$4,600, to \$7,660.

Effective Date

The bonus deduction will be allowed for property whose original use begins with the taxpayer after September 10, 2001, and acquired after September 10, 2001, but not if there was a written binding contract for the acquisition in effect before September 11, 2001. The bonus deduction generally will not be available for property acquired after September 10, 2004, unless there is a written binding contract in effect before September 11, 2001. The property must be placed in service by the taxpayer before January 1, 2005. A one-year extension of the placed-in-service date (to December 31, 2005) is provided for certain property (generally, self-constructed property) that has a recovery period of 10 years or longer or is tangible personal property used in the transportation business. However, only the portion of the property’s basis attributable to manufacture, construction or production before September 11, 2004, will be eligible for the bonus depreciation.

Five-Year Carryback Of Net Operating Losses

The Act allows a taxpayer with a net operating loss (NOL) arising in a tax year ending in 2001 or 2002 to carry those losses back to be used as a deduction in the fifth preceding tax year, rather than in the second preceding tax year. For example, a calendar-year taxpayer would carry a loss incurred in 2001 back to 1996.

The five-year carryback also applies to “eligible losses” that are allowed a three-year carryback: certain casualty and theft losses of individuals and certain losses of a small business or a farmer in a Presidentially declared disaster area.

Losses eligible to be carried back five years under this rule remain eligible for a 20-year carryover if they cannot be used to offset income in the carryback years.

A taxpayer can elect to disregard the five-year carryback for any loss year in the period covered by this provision and, thus, to have losses for that year carried back under the usual two- or three-year carryback rule. The election must be made by the due date for filing the tax return for the loss year (including any extensions) and, once made, is irrevocable.

Taxpayers also will remain eligible, as under prior law, to elect to waive any carryback of net operating losses from a tax year, and only carry them forward.

The five-year carryback does not eliminate other special carryback rules. Thus, the five-year carryback does not apply to:

- Net operating losses of REITs
- Losses attributable to certain interest expense relating to a corporate equity reduction transaction
- “Operations loss” carrybacks of life insurance companies (which are carried back three years and carried forward 15 years)

The Act does not eliminate the ability to carry back “specified liability losses” 10 years.

The five-year carryback applies for purposes of computing AMT, as well as regular tax, and an election not to use the five-year carryback would apply for both AMT and regular tax. Whether or not the five-year carryback applies, however, an AMT NOL deduction attributable to a net operating loss arising in 2001 or 2002, or carried forward from an earlier tax year into 2001 or 2002, may offset 100 percent of a taxpayer’s alternative minimum taxable income for the year it is deducted (*i.e.*, it will not be subject to the 90-percent limitation on the deductibility of AMT NOLs).

Suspension of Reduction of Deductions for Mutual Life Insurance Companies

Mutual life insurance companies are allowed to deduct certain amounts returned to policyholders in their status as customers, rather than as owners, of the company. The insurance company, however, is required to reduce the amount of its deduction for such policyholder dividends by the company’s “differential earnings amount,” which is a factor of a “differential earnings rate” based on industry experience.

The Act provides a zero percent differential earnings rate and recomputed differential earnings rate for mutual life insurance company tax years beginning in 2001, 2002, and 2003.

Extensions of Expiring Provisions

Exception Under Subpart F for Active Financing Income

The Act extends for five years, through 2006, the exception from subpart F for “active financing” income. The active financing income exception is available for certain:

- Foreign personal holding company income
- Foreign base company services income
- Insurance income

The income must be derived from the active conduct of a banking, financing or securities business, or in the conduct of an insurance business, by a controlled foreign corporation (CFC).

KPMG Observation

The exception allows U.S. taxpayers to continue banking and financing activities in foreign jurisdictions without having to pay current U.S. tax, putting banking and financial services taxpayers on equal footing with manufacturers under the subpart F regime.

Work Opportunity Credit

Employers may receive the work opportunity tax credit when they hire workers from one or more targeted groups. The credit generally is equal to 40 percent of wages paid in the first year (25 percent for employment of less than 400 hours) for a maximum credit of \$2,400 per employee (\$1,200 per summer youth employee).

The Act extends the work opportunity tax credit for two years. The credit is available for wages paid to or incurred for a qualified individual who begins work for an employer before 2004.

Welfare-to-Work Credit

Employers may receive the welfare-to-work tax credit on the first \$10,000 of eligible wages paid to recipients of long-term family assistance during each of the first two years of employment, for a maximum credit over the two years of \$8,500 per qualified employee.

The Act extends the welfare-to-work credit for two years. The credit is available for wages paid or incurred by the employer to qualified individuals who begin work for an employer before 2004.

Suspension of Depletion Limitation for Marginal Oil and Gas Wells

Percentage depletion deductions with respect to an oil or gas property generally may not exceed 100 percent of the net income from the property. The limitation was suspended for tax years beginning after 1997 and before 2002 for domestic production from marginal wells.

The Act extends the suspension of the 100-percent-of-net-income limitation for two additional years, to tax years beginning before 2004.

Cover Over of Rum Excise Tax

The Act extends through December 31, 2003, the increase in the portion of the federal excise tax collected on rum (to \$13.25 from \$10.50 per proof gallon) brought into the United States from Puerto Rico or the U.S. Virgin Islands that is “covered over” (*i.e.*, paid) to those jurisdictions.

Credit for Energy Produced from Renewable Sources

The Act extends the credit for electricity produced from wind, closed-loop biomass, and poultry waste for two additional years. The credit is available for qualified facilities placed in service before 2004.

Repeal of Dyed-Fuel Mandate

The Act repeals a statutory mandate⁶ that a fuel terminal must offer untaxed, dyed diesel fuel and kerosene if the terminal operator wishes to offer taxed, undyed diesel fuel and kerosene.

KPMG Observation

The dyed-fuel mandate was enacted in 1997 and has never gone into effect. Many fuel producers argued that supplies of dyed fuel are readily available without the mandate.

Mental Health Parity Excise Tax

Group health plans offering both mental health and medical and surgical benefits may not impose aggregate lifetime or annual dollar limits on mental health benefits that are not imposed on substantially all medical and surgical benefits. Employers sponsoring noncompliant plans must pay an excise tax of \$100 per affected participant per day during the period of noncompliance, subject to a maximum tax (per tax year) of the lesser of: (1) 10 percent of the employer’s group health plan expenses for the prior year or (2) \$500,000.

⁶ IRC section 4101(e).

The Act extends the excise tax to benefits for services provided before 2004.

Deduction for Cost of Clean-Fuel Vehicles and Vehicle Refueling Property

Taxpayers may deduct currently the costs of certain vehicles fueled by natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, electricity, or certain alcohol-based fuels (including ethanol and methanol). For such clean-fuel vehicles, the deduction is limited to:

- \$2,000 for cars
- \$5,000 for light trucks and vans
- \$50,000 for heavy trucks, vans, and buses

The Act delays a scheduled phase-out of the deduction for qualified clean-fuel vehicles for two years, to allow a deduction for property placed in service before 2007. For clean-fuel vehicles, the phase-out schedule of the deduction is:

Year Vehicle Placed in Service	Maximum Deduction for Cars	Maximum Deduction for Light Trucks and Vans	Maximum Deduction for Other Trucks, Vans, and Buses
Before 2004	\$2,000	\$5,000	\$50,000
2004	\$1,500	\$3,750	\$37,500
2005	\$1,000	\$2,500	\$25,000
2006	\$500	\$1,250	\$12,500
After 2006	No deduction	No deduction	No deduction

A deduction also is available for qualifying refueling property for clean-fuel vehicles. The lifetime deduction (*i.e.*, the total deductions for all tax years) for refueling property is limited to \$100,000 per location. The Act extends the deduction for clean-vehicle refueling property for two years to property placed in service before 2007.

Credit for Qualified Electric Vehicles

A 10-percent credit (up to a maximum credit of \$4,000) is available for the purchase of certain new electric vehicles. The Act delays the phase-out of the credit for two years. The following table describes the new phase out schedule:

Year Vehicle Placed in Service	Credit (as % of Cost)	Maximum Credit
Before 2004	10%	\$4,000
2004	7.5%	\$3,000
2005	5%	\$2,000
2006	2.5%	\$1,000
After 2006	No credit	No credit

Medical Savings Accounts

The Medical Savings Account (Archer MSA) program permits certain self-employed individuals and employees of small businesses to open tax-free accounts that can be used to pay for certain medical expenses. The Archer MSA program was scheduled to expire at the end of 2002. The Act extends the program one year, through 2003.

Incentives for Investment on Indian Reservations

A credit of 20 percent is available for up to \$20,000 of qualified wages and health insurance paid each year to a qualified employee who works on an Indian reservation. In addition, a special depreciation recovery period is allowed for qualified Indian reservation property. The credit expires for tax years beginning after 2003; the depreciation rule expires for property placed in service after 2003. The Act extends the Indian employment credit and the depreciation rules for Indian reservations for one year, for wages and insurance paid in tax years beginning before 2005, and property placed in service before 2005.

Use of Nonrefundable Credits Against AMT

Generally, nonrefundable tax credits are allowed only to the extent that a taxpayer's regular income tax liability exceeds the tentative minimum tax. This means that these nonrefundable credits cannot offset AMT liability. Nonrefundable personal credits could be used against AMT, but only for tax years beginning before 2002. The Economic Growth Tax Reconciliation and Relief Act of 2001⁷ made this rule permanent for the child credit (beginning in 2001) and the adoption credit (beginning in 2002). The personal tax credits that remain subject to the temporary rule are:

- Dependent care credit
- Credit for the elderly and permanently disabled
- Credit for interest on certain home mortgages
- Hope and Lifetime Learning credits
- The DC homeowner's credit

The Act extends the temporary provision for two years, for tax years beginning in 2002 and 2003.

Qualified Zone Academy Bonds

State and local governments can issue qualified zone academy bonds (QZABs) to fund the improvement of eligible public schools. An eligible holder of a QZAB receives annual federal income tax credits in lieu of interest. For 1998 through 2001, there was authority for governments to issue \$400 million per year of QZABs. The Act authorizes another \$400 million per year of QZABs to be issued in 2002 and in 2003.

⁷ Pub. L. No. 107-16.

Revenue Offsets and Miscellaneous Provisions

Discharge of Indebtedness of an S Corporation (Override of Gitlitz)

The Act overrides the result in *Gitlitz v. Commissioner*, 531 U.S. 236 (2001). The Act provides that discharge of indebtedness income that is excluded from the income of an S corporation cannot be used to increase a shareholder's basis in S corporation stock, effective for discharges of indebtedness occurring after October 11, 2001. A transitional rule exempts discharges made before March 1, 2002, pursuant to a plan of reorganization filed on or before October 11, 2001.

In *Gitlitz*, the U.S. Supreme Court allowed excluded discharge of indebtedness income to be taken into account for purposes of determining an S corporation shareholder's basis.

KPMG Observation

S corporation shareholders may continue to recognize an increase in the basis of their S corporation shares for income attributable to discharges of indebtedness that occurred on or before October 11, 2001. Taxpayers who hold or held shares in an S corporation whose debt was relieved prior to October 12, 2001, should review their basis calculations, as they may still benefit from the decision in *Gitlitz*.

Limitation on Use of the Nonaccrual Experience Method of Accounting

The nonaccrual experience method of accounting allows accrual basis taxpayers to exclude from gross income certain income from services that, based on the taxpayer's experience, it does not expect to collect. Temporary regulations⁸ mandate the use of a specific formula to determine the amount that is not expected to be collected.

The Act limits the use of the nonaccrual experience method of accounting to amounts to be received for the performance of qualified personal services: health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting. The nonaccrual experience method also may be used by accrual method taxpayers with average annual gross receipts of \$5 million or less.

Taxpayers that are no longer eligible to use the method are required to change their method of accounting for the first tax year ending after the date of enactment⁹ (e.g., calendar year 2002). Any adjustment necessitated by such change will be taken into income over a period of up to four years beginning with the tax year in which the change is required.

⁸ Treas. Reg. section 1.448-2T(e).

⁹ Date of enactment is March 9, 2002.

The Act also provides greater flexibility in determining the amount that, on the basis of experience, will not be collected. The Secretary of the Treasury is directed to issue regulations allowing taxpayers to adopt, or change to, any computation or formula that clearly reflects the taxpayer's experience.

KPMG Observation

The provision modifying the nonaccrual experience method provides opportunities for taxpayers that continue to be eligible to use the method.

In many cases, the nonaccrual experience formula mandated in the temporary regulations underestimates the amount of service receivables a taxpayer will not collect. This is particularly true where receivables can be outstanding for significant periods of time. As a result, many taxpayers that were eligible to use the nonaccrual experience method did not elect to do so. Accrual method taxpayers that provide qualified personal services should now consider whether an election to adopt the nonaccrual experience method is advantageous. Taxpayers that previously adopted the nonaccrual experience method should review their records to determine if a different formula would be more beneficial.

Electronic Delivery of Forms 1099

The Act allows Forms 1099 to be furnished electronically to a taxpayer if the taxpayer consents to electronic transmission. The provision is effective on the date of enactment (March 9, 2002).

KPMG Observation

Unless the Secretary of the Treasury authorizes a different procedure, it is expected that the recipient will be required to consent affirmatively to the use of an electronic Form 1099.

The provision could reduce the federal income tax reporting costs of banks and financial institutions. Banks and other financial institutions have been required to provide their customers with a Form 1099 in paper form. Providing paper Forms 1099 can be costly, especially since they are required for even very small payments of income.

Interest Rate Used in Determining Additional Required Contributions to Defined Benefit Plans and Pension Benefit Guaranty Corporation (PBGC) Variable Rate Premiums

The Act expands the permissible range of the statutory interest rate used in calculating an underfunded defined benefit plan's current liability for purposes of applying the additional contribution requirements on account of the underfunding.

KPMG Observation

Defined benefit plans have minimum funding requirements that determine the amount of contributions or additional contributions required for a plan year. The interest rate used to determine a plan's current liability and the PBGC premiums for such plans are based on interest rates on 30-year Treasury securities.

However, Treasury stopped issuing 30-year Treasury securities in 2001, and the extrapolated interest rate that has been used instead has been very low, forcing plan sponsors to make contributions larger than if a market rate of interest were used.

The Act allows a higher interest rate to be used (up to 120 percent, instead of 115 percent, of the extrapolated 30-year Treasury security rate) in plan years beginning in 2002 or 2003. Special rules are provided for determining quarterly contribution requirements for plan years beginning in 2002 and again in 2004 (when the expanded range ceases to apply).

Also, the Act raises the interest rate used in 2002 and 2003 to determine the amount of unfunded vested benefits for PBGC variable rate premiums purposes from 85 percent to 100 percent of the extrapolated interest rate on 30-year Treasury securities for the month preceding the month in which the plan year begins.

Exclusion from Income for Qualified Foster Care Payments

The definition of "qualified foster care payments" is expanded to include payments by a placement agency that is licensed or certified by a state or local government (or an entity designated by such government) to make payments to providers of foster care. Also, the definition of a "qualified foster care individual" is expanded to include an individual placed by a qualified foster care placement agency, regardless of the individual's age at placement.

This provision is effective for tax years beginning after 2001.

Deduction for Classroom Materials

The Act provides an annual above-the-line deduction for up to \$250 of expenses paid or incurred by an eligible educator for certain books, supplies, computer equipment, and supplementary materials used by the educator in the classroom. The expense must otherwise qualify as a trade or business expense.

An "eligible educator" is an individual who is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide in a school for at least 900 hours during the school year. The deduction is allowed only to the extent that the expenses exceed the amount excludable under certain other tax provisions relating to educational expenses.

The exclusion is effective for tax years beginning after 2001.

Tax Benefits for New York City Area Damaged in Terrorist Attacks

Expansion of Work Opportunity Tax Credit for Certain Employees in New York

The Act expands the list of targeted groups eligible for the work opportunity tax credit to include individuals who perform substantially all of their services in:

- The New York Liberty Zone for a business located in the New York Liberty Zone, or
- Elsewhere in New York City, if the business relocated from the New York Liberty Zone because of the physical destruction or damage to its workplace by the September 11, 2001 terrorist attack.

The New York Liberty Zone is an area around the site of the World Trade Center, on or south of Canal Street, East Broadway (east of its intersection with Canal Street), or Grand Street (east of its intersection with East Broadway) in the Borough of Manhattan in the City of New York.

This credit -- 40 percent of up to \$6,000 of wages per employee each year -- for the new targeted group is for existing employees and rehires, as well as new hires. The general limitation of the credit to first-year wages does not apply to the new group. The credit may offset tax liability even if it is reduced below tentative minimum tax.

For businesses relocating elsewhere in New York City, the Act generally limits the number of employees eligible for the credit to the number of employees the employer had in the New York Liberty Zone on September 11, 2001. Employers with an average of more than 200 employees on business days during the tax year may not claim the credit.

The credit is allowed for wages paid or incurred to qualified individuals for work during 2002 and 2003.

Special Depreciation Allowance for Certain Property

The Act provides a special 30-percent bonus depreciation for certain qualified property acquired after September 10, 2001, and used in the New York Liberty Zone.

The Liberty Zone bonus is available for certain property that is not eligible for the general bonus depreciation. The Liberty Zone bonus is allowed for the costs of rehabilitating or replacing nonresidential and residential real property that was damaged, destroyed, or condemned as a result of the September 11, 2001 terrorist attack. For such real property, the Liberty Zone bonus is available if the property is placed in service by December 31, 2009.

The Liberty Zone bonus is also generally available for property acquired and placed in service through 2006 that otherwise would have been eligible for the general bonus depreciation, but does not satisfy the 2004 acquisition and placed-in-service dates that

apply for the general bonus depreciation.

However, qualified leasehold improvements in the Liberty Zone do not qualify for the Liberty Zone bonus.

The other rules for the general 30-percent bonus depreciation generally apply to the Liberty Zone bonus, including the rule that the property generally must be acquired by the taxpayer after September 10, 2001.

Example

In 2002, the taxpayer acquires and places in service qualified property within the New York Liberty Zone that costs \$1 million. The taxpayer is allowed a special deduction of \$300,000. The remaining \$700,000 of adjusted basis is recovered in 2002 and subsequent years pursuant to the depreciation rules.

KPMG Observation

To qualify, the property does not need to be used originally in the New York Liberty Zone. It is sufficient that the property is purchased by the taxpayer within the designated period of time, and that the use of the property in the New York Liberty Zone commences on or after September 11, 2001. In other words, new or used property acquired by the taxpayer after September 10, 2001, and placed in service before 2007, and used by the taxpayer in the New York Liberty Zone qualifies for the 30-percent deduction.

Authorization of Tax-Exempt Private Activity Bonds

The Act authorizes the issuance of \$8 billion of exempt facility bonds to finance the construction and rehabilitation of commercial and residential rental real property located in the New York Liberty Zone. Property eligible for financing includes buildings and their structural components, fixed tenant improvements, and public utility property, as designated by either the Mayor of New York City or the Governor of New York. The bonds may be issued after the date of enactment (March 9, 2002) and before 2005. If the Mayor or Governor determines that it is not feasible to use all of the authorized bond proceeds for property located in the designated areas, up to \$1 billion may be used for construction and rehabilitation of nonresidential real property located in other areas within New York City.

Some of the rules applicable to the issuance of exempt facility private activity bonds will not apply to these bonds.

Allow One Additional Advance Refunding for Certain Previously Refunded Bonds

The Act permits up to \$9 billion of eligible bonds issued to finance certain facilities located in New York City to be “advance refunded” one additional time.

Background – Advance Refunding Bonds

A refunding bond is a bond issued to redeem a previously issued bond. An “advance refunding” occurs when the refunded debt is not redeemed within 90 days after the refunding bonds are issued. Proceeds of the advance refunding are held in an escrow account until the debt to be refunded may be redeemed under its terms.

Eligible bonds are those (1) for which advance refunding authority was exhausted before September 12, 2001, and (2) with respect to which the advance refunding was outstanding on September 11, 2001. Bonds must be designated as eligible bonds by the Mayor of New York City or the Governor of New York State. Up to \$4.5 billion of bonds may be designated by each of these officials.

Eligible bonds are:

- Governmental general obligation bonds of New York City
- Governmental bonds issued by the Metropolitan Transportation Authority of the State of New York
- Governmental bonds issued by the New York Municipal Water Finance Authority
- Qualified 501(c)(3) bonds issued by or on behalf of New York State or New York City to finance hospital facilities (as defined in section 145(c))

Increase in Expensing Under Section 179 for Business Property Used in the New York Liberty Zone

The Act increases the amount a taxpayer can deduct under section 179 to include up to an additional \$35,000 per year of qualified property that is used in the New York Liberty Zone. Generally, qualified property must be purchased and placed in service by the taxpayer after September 10, 2001, and before 2007. Substantially all of its use must be in an active trade or business in the New York Liberty Zone, and the taxpayer must begin such use in the Zone after September 10, 2001.

Section 179 allows a taxpayer to elect to treat as an expense the cost of up to \$25,000 of tangible personal property (\$24,000 in 2001 and 2002). The deduction must be reduced to the extent more than \$200,000 of such property is placed in service during the year. Under the Act, the reduction is 50 cents per dollar for qualified property used in the New York Liberty Zone (the general reduction is dollar for dollar for section 179 property).

The Act authorizes the Secretary of the Treasury to issue regulations providing for the recapture of the additional section 179 benefit if the property is removed from the New York Liberty Zone.

Extension of Replacement Period for Certain Property Involuntarily Converted

Upon an involuntary conversion of property, a taxpayer generally may elect not to recognize gain with respect to the conversion if the taxpayer acquires within a designated period property similar to or related in service or use to the converted property ("replacement property"). If a taxpayer elects to purchase replacement property and trigger the nonrecognition provision, gain on the converted property is recognized only to the extent that the amount realized on the conversion exceeds the cost of the replacement property. In general, the replacement period begins with the date of the disposition of the converted property and ends two years after the close of the first tax year in which any part of the gain on conversion is realized.

The Act extends the replacement period to five years for property destroyed as a result of the September 11, 2001 terrorist attack in the New York Liberty Zone. The five-year period is available only if substantially all of the use of the replacement property is in New York City.

Treatment of Qualified Leasehold Improvement Property

The Act treats qualified leasehold improvement property located in the New York Liberty Zone as 5-year property for depreciation purposes. The straight line method of depreciation must be used. For purposes of the alternative depreciation system, the property has a 9-year recovery period.

Qualified leasehold improvement property is property placed in service after September 10, 2001, and before January 1, 2007, and includes any improvement to an interior portion of a building that is nonresidential real property (generally a commercial building) if the building is located in the New York Liberty Zone. The improvement must be made under or pursuant to a lease either by the lessee (or a sublessee) of that portion of the building or by the lessor of that portion of the building. For this purpose, a lease between related persons is not considered a lease. The portion of the building that includes the improvement must be occupied exclusively by the lessee (or any sublessee). The improvement must be placed in service more than three years after the date the building was first placed in service.

Qualified leasehold improvement property does not include improvements that:

- Enlarge the building
- Are for elevators or escalators
- Are to structural components benefiting a common area
- Are to the internal structural framework of the building

Without the special rule, improvements in most cases would be subject to the 39-year depreciation recovery period. Liberty Zone qualified leasehold improvements are not eligible for 30-percent bonus depreciation.

Unemployment Assistance Provisions

The Act provides for up to 13 weeks of temporary extended unemployment benefits for eligible displaced workers. The extension applies in any state that enters into an agreement with the Secretary of Labor to provide these extended benefits. The extended benefits are available for workers who applied for unemployment on or after March 15, 2001, and have no remaining unemployment benefits.

This provision follows current law for certain eligibility rules for benefits. In states that experience a high rate of unemployment, workers who have used their 13 weeks of extended unemployment benefits may be eligible for an additional 13 weeks. All extended benefits will be federally funded and available through December 31, 2002, or until a state terminates its agreement (if sooner).

Temporary Assistance to Needy Families (TANF) Provisions

For 1998 through 2001, certain states with high population growth and/or low federal expenditures per person under welfare programs were eligible for supplemental grants under the TANF Supplemental Grant program. This program expired on September 30, 2001.

The Act reauthorizes the TANF Supplemental Grant program and provides appropriations for fiscal year 2002. Individual state grant amounts are frozen at the amount received by the state in fiscal year 2001.

Technical Corrections

The Act includes technical corrections.

Amendments to the Economic Growth and Tax Relief Reconciliation Act of 2001¹⁰

- Section 6428 credit interaction with refundable child tax credit
- Child tax credit
- Transition rule for adoption tax credit
- Dollar amount of credit for special needs adoptions
- Employer-provided adoption assistance exclusion with respect to special needs adoptions
- Credit for employer expenses for child care assistance
- Elimination of marriage penalty in standard deduction
- Education IRAs; non-application of 10-percent additional tax with respect to amounts for which HOPE credit is claimed
- Transfers in trust
- Recovery of taxes claimed as credit (state death tax credit)

Pension-Related Amendments to the Economic Growth and Tax Relief Reconciliation Act of 2001¹¹

- Individual Retirement Arrangements (IRA)
- Increase in benefit and contribution limits
- Modification of top-heavy rules
- Elective deferrals not taken into account for deduction limits
- SEP deduction limits
 - The annual limit on the amount of a deductible contribution that can be made to a Simplified Employee Pension (SEP) is increased to 25 percent from 15 percent of compensation. This is a conforming change to the rule that limits the amount of SEP contributions that may be made for a particular employee.
- Nonrefundable credit for certain individuals for elective deferrals and IRA contributions
- Small business tax credit for new retirement plan expenses
- Additional salary reduction catch-up contributions
- Equitable treatment for contributions of employees to defined contribution plans
- Rollovers of retirement plan and IRA distributions
- Employers may disregard rollovers for purposes of cash-out amounts
- Notice of significant reduction in plan benefit accruals
- Modification of timing of plan valuations
- ESOP dividends may be reinvested without loss of dividend deduction

¹⁰ Pub. L. No. 107-16.

¹¹ Pub. L. No. 107-16.

Amendments to the Community Renewal Tax Relief Act of 2000¹²

- Phaseout of \$25,000 amount for certain rental real estate under passive loss rules
- Treatment of missing children
- Basis of property in an exchange by a corporation involving assumption of liabilities
- Tax treatment of securities futures contracts

Amendment to the Tax Relief Extension Act of 1999¹³

- Taxable REIT subsidiaries – 100-percent tax on improperly allocated amounts

Amendments to the Taxpayer Relief Act of 1997¹⁴

- Election to recognize gain on assets held on January 1, 2001
 - Treatment of gain on sale of principal residence
 - Treatment of disposition of interest in passive activity

Amendments to the Balanced Budget Act of 1997¹⁵

- Medicare+Choice MSA

Amendments to other Acts

- Advance payments of earned income credit
- Coordination of wash sale rules and section 1256 contracts
- Disclosure by the Social Security Administration to federal child support enforcement agencies
- Treatment of settlements under partnership audit rules
 - Clarification that the TEFRA partnership audit procedures covering settlement agreements entered into by the Treasury Secretary also apply to settlement agreements entered into by the Attorney General.
 - Settlement agreements entered into by the Attorney General with a partner with respect to partnership items will convert to nonpartnership items, thus permitting other partners to request consistent settlement terms. Similar changes are made to related provisions with respect to settlement agreements.
- Clarification of permissible extension of limitations period for installment agreements
- Determination of whether a life insurance contract is a modified endowment contract

Additional Corrections

- Adoption credit and employer-provided adoption assistance exclusion rounding rules
- Dependent care credit

¹² Pub. L. No. 106-554.

¹³ Pub. L. No. 106-170.

¹⁴ Pub. L. No. 105-34.

¹⁵ Pub. L. No. 105-33.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability to specific situations is to be determined through consultation with your tax adviser.