RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

"Recent developments are just like ancient history, except they happened less long ago."

By

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On December 22, 2017, the President signed legislation that makes significant amendments to the Internal Revenue Code of 1986. This legislation, which became Pub. L. No. 115-97, is colloquially referred to as the Tax Cuts and Jobs Act ("TCJA"). This outline refers to the legislation in this manner and summarizes changes that, in our judgment, are the most important. The outline does not attempt to list the legislation's provisions comprehensively or to explain them in detail. For further explanation and details, the complete Conference Report accompanying TCJA may be found here. Finally, readers should note that many of the TCJA changes affecting individual taxpayers are temporary and sunset for taxable years beginning after December 31, 2025.

I. ACCOUNTING

A. Accounting Methods

1. Many more taxpayers now can use the cash method of accounting. The 2017 Tax Cuts and Jobs Act, § 13102, made several amendments to expand the universe of C corporations, partnerships, and businesses with inventory that can use the cash method of accounting. These amendments apply to taxable years beginning after 2017.

General Rules for C Corporations. Code § 448(a) provides as a general rule that a C corporation, or a partnership with a C corporation as a partner, cannot use the cash method of accounting. Prior to amendment by the 2017 Tax Cuts and Jobs Act, an exception in § 448(b)(3) provided that this prohibition did not apply to an entity that met a gross receipts test for *all* prior tax years, and § 448(c)(1) provided that an entity met the gross receipts test for a year if its average annual gross receipts (measured over the three preceding tax years) did not exceed $5 million. The legislation made two significant changes. *First,* the legislation removed the requirement that an entity must meet the gross receipts test for all prior tax years in order to use the cash method. Instead, under amended § 448(b)(3), the inquiry is simply whether the entity's average annual gross receipts, measured over the three preceding tax years, were below a specified limit. *Second*, the legislation increased the $5 million limit to $25 million. Accordingly, a C corporation, or a partnership with a C corporation as a partner, can use the cash method of accounting for a year if its average annual gross receipts, measured over the three prior years, do not exceed $25 million.

Farming C Corporations. Under Code § 447(a), taxable income from farming of a C corporation (or a partnership with a C corporation as a partner) engaged in the trade or business of farming must be determined using the accrual method of accounting. Prior to amendment by the 2017 Tax Cuts and Jobs Act, § 447(c)(2) provided that that this requirement did not apply if the C corporation met the gross receipts test specified in § 447(d). This gross receipts test required that, for all prior tax years, the C corporation's gross receipts must not have exceeded $1 million ($25 million in the case of family corporations). The legislation amended § 447(c)(2) to apply the same gross receipts test (in § 448(c)) that applies to C corporations generally. Pursuant to this amendment, a C corporation (or a partnership with a C corporation as a partner) engaged in the trade or business of farming can use the cash method of accounting for a year if its average annual gross receipts, measured over the three prior years, do not exceed $25 million.

Businesses with Inventory. Under § 471(c)(1)(A) as amended by the 2017 Tax Cuts and Jobs Act, a business that meets the gross receipts test of § 448(c) (average annual gross receipts, measured over the three prior years, do not exceed $25 million) can use the cash method of accounting *even if inventories are a material income-producing factor*. Thus, even if a C corporation has inventory, as long as it meets the gross receipts test, it can use the cash method of accounting.

Inflation Adjustment. According to § 448(c)(4), as amended by the 2017 Tax Cuts and Jobs Act, the $25 million figure used for purposes of the average gross receipts test will be adjusted for inflation (rounded to the nearest million) for taxable years beginning after 2018.

Change in Method of Accounting. A business that changes from the accrual method to the cash method to take advantage of the new rules will have a change in method of accounting. According to §§ 447(d) and 448(d)(7), these changes in method of accounting are treated as made with the consent of the IRS. Presumably, the IRS will issue automatic change procedures to facilitate such changes.

2. Congress has expanded the small construction contract exception to the percentage-of-completion method of accounting. Generally, § 460(a) requires taxpayers to account for long-term contracts using the percentage-of-completion method of accounting. An exception exists, commonly known as the "small construction contract" exception, pursuant to which a taxpayer need not use the percentage-of-completion method for construction contracts if (1) at the time the contract is entered into, the taxpayer expects the contract to be completed within the two-year period beginning on the contract commencement date, and (2) the taxpayer's average annual gross receipts (measured over the three taxable years preceding the taxable year in which such contract is entered into) do not exceed a specified limit. Prior to amendment by the 2017 Tax Cuts and Jobs Act, § 460(e)(1)(B)(ii) provided that that this limit was $10 million. Section 13102 of the legislation amended Code § 460(e)(1)(B)(ii) to provide that the test used for purposes of the second part of the small construction contract exception is the gross receipts test of § 448(c) (average annual gross receipts, measured over the three prior years, do not exceed $25 million). This change applies to contracts entered into after December 31, 2017, in taxable years ending after that date. Any change in method of accounting that a taxpayer makes pursuant to this new rule is treated, according to § 460(e)(2)(B), as made with the consent of the IRS and must be effected on a cut-off basis for all similarly classified contracts entered into on or after the year of change.

B. Inventories

1. **Simplified inventory accounting for small businesses.** Under § 471(a) and Reg. § 1.471-1, taxpayers for whom the production, purchase, or sale of merchandise is an income-producing factor must account for inventories. Generally, under Reg. § 1.446-1(c)(2), when the use of inventories is necessary to clearly reflect income, a taxpayer must use the accrual method for purchases and sales. The 2017 Tax Cuts and Jobs Act, § 13102, redesignated § 471(c) as § 471(d) and added new § 471(c). New § 471(c) provides that taxpayers meeting the gross receipts test of § 448(c) (average annual gross receipts, measured over the three prior years, do not exceed $25 million) are not required to account for inventories under § 471. Instead, such taxpayers can use a method of accounting for inventories that either (1) treats inventories as non-incidental materials and supplies, or (2) conforms to the taxpayer's financial accounting treatment of inventories (either in an "applicable financial statement" as defined in § 451(b)(3) or in the taxpayer's books and records). This rule applies to taxable years beginning after 2017. Any change in method of accounting that a taxpayer makes pursuant to this new rule is treated, according to § 471(c)(4), as made with the consent of the IRS. Presumably, the IRS will issue automatic change procedures to facilitate such changes.

C. Installment Method

D. Year of Income or Deduction

1. **An expanded exception to the uniform capitalization rules for small businesses.** The 2017 Tax Cuts and Jobs Act, § 13102, redesignated Code § 263A(i) as § 263A(j) and added new § 263A(i). New § 263A(i) excludes from the uniform capitalization rules of § 263A any taxpayers meeting the gross receipts test of § 448(c) (average annual gross receipts, measured over the three prior years, do not exceed $25 million). In the case of a taxpayer other than a corporation or a partnership, the gross receipts test is applied as if each trade or business of the taxpayer were a corporation or partnership. This exclusion is broader than one that existed before this change. Prior to this amendment, taxpayers that produced property and those that acquired property for resale generally were subject to § 263A, but an exception existed for taxpayers acquiring property for resale with average annual gross receipts that did not exceed $10 million. Under new § 263A(i), all taxpayers (other than tax shelters), including those that produce property, with average annual gross receipts that do not exceed $25 million, are not subject to the uniform capitalization rules. This provision applies to taxable years beginning after 2017. Any change in method of accounting that a taxpayer makes pursuant to this new rule is treated, according to § 263A(i)(3), as made with the consent of the IRS. Presumably, the IRS will issue automatic change procedures to facilitate such changes.

2. **Accrual-method taxpayers may have to recognize income sooner as a result of legislative changes.** The 2017 Tax Cuts and Jobs Act, § 13221, amended Code § 451 to make two changes that affect the recognition of income and the treatment of advance payments by accrual method taxpayers. Both changes apply to taxable years beginning after 2017. Any change in method of accounting required by these amendments for taxable years beginning after 2017 is treated as initiated by the taxpayer and made with the consent of the IRS.

All events test linked to revenue recognition on certain financial statements. The legislation amended Code § 451 by redesignating § 451(b) through (i) as § 451(d) through (k) and adding a new § 451(b). New § 451(b) provides that, for accrual-method taxpayers, "the all events test with respect to any item of gross income (or portion thereof) shall not be treated as met any later than when such item (or portion thereof) is taken into account as revenue in" either (1) an applicable financial statement, or (2) another financial statement specified by the IRS. Thus, taxpayers subject to this rule must include an item in income for tax purposes upon the earlier of satisfaction of the all events test or recognition of the revenue in an applicable financial statement (or other specified financial statement). According to the Conference Report that accompanied the legislation, this means, for example, that any unbilled receivables for partially performed services must be recognized to the extent the amounts are taken into income for financial statement purposes. Income from mortgage servicing contracts is not subject to the new rule. The new rule also does not apply to a taxpayer that does not have either an applicable financial statement or another specified financial statement. An "*applicable financial statement*" is defined as **(1)** a financial statement that is certified as being prepared in accordance with generally accepted accounting principles that is **(a)** a 10-K or annual statement to shareholders required to be filed with the Securities and Exchange Commission, **(b)** an audited financial statement used for credit purposes, reporting to shareholders, partners, other proprietors, or beneficiaries, or for any other substantial nontax purpose, or **(c)** filed with any other federal agency for purposes other than federal tax purposes; **(2)** certain financial statements made on the basis of international financial reporting standards and filed with certain agencies of a foreign government; or **(3)** a financial statement filed with any other regulatory or governmental body specified by IRS.

Advance payments for goods or services. The legislation amended Code § 451 by redesignating § 451(b) through (i) as § 451(d) through (k) and adding a new § 451(c). This provision essentially codifies the deferral method of accounting for advance payments reflected in Rev. Proc. 2004-34, 2004-22 I.R.B. 991. New § 451(c) provides that an accrual-method taxpayer who receives an advance payment can either (1) include the payment in gross income in the year of receipt, or (2) elect to defer the category of advance payments to which such advance payment belongs. If a taxpayer makes the deferral election, then the taxpayer must include in gross income any portion of the advance payment required to be included by the applicable financial statement rule described above, and include the balance of the payment in gross income in the taxable year following the year of receipt. An advance payment is any payment: (1) the full inclusion of which in gross income for the taxable year of receipt is a permissible method of accounting (determined without regard to this new rule), (2) any portion of which is included in revenue by the taxpayer for a subsequent taxable year in an applicable financial statement (as previously defined) or other financial statement specified by the IRS, and (3) which is for goods, services, or such other items as the IRS may identify. The term "advance payment" does *not* include several categories of items, including rent, insurance premiums, and payments with respect to financial instruments.

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

1. When we said tangible personal property, we really meant tangible personal property, says Congress. Under § 74(c), an employee can exclude from gross income the value of an "employee achievement award," and the employer's deduction for such an award is limited by § 274(j)(1). An employee achievement award is defined in § 274(j)(3)(A)(i) as an item of tangible personal property transferred by an employer to an employee that is awarded as part of a meaningful presentation and under conditions and circumstances that do not create a significant likelihood of the payment of disguised compensation. The 2017 Tax Cuts and Jobs Act, § 13310, amended Code § 274(j) to add a definition of "tangible personal property" in new § 274(j)(3)(A)(ii). Under this definition, the term "tangible personal property" does not include either (1) cash, cash equivalents, gift cards, gift coupons, or gift certificates, or (2) vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items. Despite this definition, arrangements can qualify as an employee achievement award if they "confer only the right to select and receive tangible personal property from a limited array of such items pre-selected or pre-approved by the employer." This provision applies to amounts paid or incurred after 2017.

B. Deductible Expenses versus Capitalization

1. Required amortization of specified research or experimental expenditures incurred after 2021. The 2017 Tax Cuts and Jobs Act, § 13206, amended Code § 174 to require the capitalization and amortization of specified research or experimental expenditures. The amortization period is 5 years (15 years for expenditures attributable to foreign research), beginning at the midpoint of the year in which the expenditures are paid or incurred. The term "specified research or experimental expenditures" is defined as research or experimental expenditures paid or incurred by the taxpayer during a taxable year in connection with the taxpayer's trade or business. The term includes expenditures for software development. This rule applies to amounts paid or incurred in taxable years beginning after 2021.

C. Reasonable Compensation

1. Could we see compensation levels of top corporate officers actually decline? Code § 162(m) limits to $1 million the deduction of publicly traded corporations for compensation to covered employees (generally, certain top corporate officers). Certain types of compensation are not subject to this limit and are not taken into account in determining whether compensation exceeds $1 million, including remuneration payable (1) on a commission basis, or (2) solely on account of attainment of one or more performance-based goals if certain approval requirements are met ("performance-based compensation"). The 2017 Tax Cuts and Jobs Act, § 13601, amended Code § 162(m) to eliminate the exceptions for commissions and performance-based compensation. Accordingly, such compensation must be taken into account in determining the amount of compensation with respect to a covered employee for a taxable year that exceeds $1 million and therefore is not deductible. The legislation also amended the definition of "covered employee" in four ways: (1) the statutory definition now includes the principal executive officer and principal financial officer (whereas formerly the statutory definition referred only to the chief executive officer), (2) the definition includes persons who served as principal executive officer or principal financial officer *at any time during the taxable year* (rather than at the end of the year), (3) the definition includes officers whose compensation must be reported to shareholders under the Securities Exchange Act of 1934 by reason of their being among the *three* highest compensated officers (rather than four highest compensated officers), and (4) the definition now includes a person who was a covered employee for any preceding taxable year beginning after 2016 (which means the limit applies to compensation paid after termination of employment or after the employee's death). Finally, the legislation expands the category of corporations subject to the § 162(m) limit by defining "publicly traded corporation" to include foreign corporations publicly traded through American depositary receipts (ADRs) and certain large private corporations and S corporations. These changes apply to taxable years beginning after 2017. A transition rule provides that the changes do not apply to remuneration provided pursuant to a written binding contract that was in effect on November 2, 2017 as long as the contract is not materially modified after that date. Compensation provided pursuant to a renewal of a grandfathered contract is subject to the new rules.

D. Miscellaneous Deductions

1. Standard mileage rates for 2018. Notice 2018-3, 2018-2 I.R.B. 285 (12/14/17). The standard mileage rate for business miles in 2018 goes up to 54.5 cents per mile (from 53.5 cents in 2017) and the medical/moving rate goes up to 18 cents per mile (from 17 cents in 2017). The charitable mileage rate remains fixed by § 170(i) at 14 cents. The portion of the business standard mileage rate treated as depreciation is 25 cents per mile for 2018 (unchanged from 2017).

2. Oh, come on! No more deductions for taking a client to a professional sports game? The 2017 Tax Cuts and Jobs Act, § 13304, amended Code § 274(a) to disallow deductions for costs "[w]ith respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation." Similarly, no deduction is allowed for membership dues with respect to any club organized for business, pleasure, recreation or other social purposes. This rule applies to taxable years beginning after 2017.

3. And no more deductions for employers for most qualified transportation fringe benefits such as employer-paid parking. The 2017 Tax Cuts and Jobs Act, § 13304(c), amended Code § 274(a) by adding § 274(a)(4), which provides that, for amounts paid or incurred after 2017, no deduction is allowed for any "qualified transportation fringe" (as defined in § 132(f)) provided to an employee of the taxpayer. A qualified transportation fringe is any of the following provided by an employer to an employee: (1) transportation in a commuter highway vehicle in connection with travel between the employee's residence and place of employment, (2) any transit pass, (3) qualified parking, and (4) any qualified bicycle commuting reimbursement. Further, the legislation added new § 274(*l*), which provides:

1. **General Rule.** No deduction shall be allowed under this chapter for any expense incurred for providing any transportation, or any payment or reimbursement, to an employee of the taxpayer in connection with travel between the employee's residence and place of employment, except as necessary for ensuring the safety of the employee.
2. **Exception.** In the case of any qualified bicycle commuting reimbursement (as described in section 132(f)(5)(F)), this subsection shall not apply for any amounts paid or incurred after December 31, 2017, and before January 1, 2026.

Effect on Employers. Under § 274 as amended, an employer *cannot* deduct the cost of transportation in a commuter highway vehicle, a transit pass, or qualified parking paid or incurred after 2017. However, the employer *can* deduct the cost of a qualified bicycle commuting reimbursement paid or incurred after 2017 and before 2026.

Effect on Employees. With one exception, the legislation did not change the tax treatment of employees with respect to qualified transportation fringes. Employees can still (as under prior law) exclude from gross income (subject to applicable limitations) any of the following provided by an employer: (1) transportation in a commuter highway vehicle in connection with travel between the employee's residence and place of employment, (2) any transit pass, or (3) qualified parking. The exception is a qualified bicycle commuting reimbursement, which, under new § 132(f)(8), must be included in an employee's gross income for taxable years beginning after 2017 and before 2026.

4. Rats! We knew that we should have been architects or engineers instead of tax advisors. The 2017 Tax Cuts and Jobs Act, § 11011, added § 199A, thereby creating an unprecedented, new deduction for trade or business (and certain other) income earned by sole proprietors, partners of partnerships (including members of LLCs taxed as partnerships or as sole proprietorships), and shareholders of S corporations. New § 199A is intended to put owners of flow-through entities (but also including sole proprietorships) on par with C corporations that will benefit from the new reduced 21% corporate tax rate; however, in our view, the new provision actually makes many flow-through businesses even more tax-favored than they were under pre-TCJA law.

Big Picture. Oversimplifying a bit to preserve our readers' (and the authors') sanity, new § 199A essentially grants a special 20 percent deduction for "qualified business income" (principally, trade or business income, but not wages) of certain taxpayers (but not most personal service providers except those falling below an income threshold). In effect, then, new § 199A reduces the top marginal rate of certain taxpayers with respect to their trade or business income (but not wages) by 20 percent (i.e., the maximum 37 percent rate becomes 29.6 percent on qualifying business income assuming the taxpayer is not excluded from the benefits of the new statute). Most high-earning (over $415,000 taxable income if married filing jointly) professional service providers (including lawyers, accountants, investment advisors, physicians, etc., but *not* architects or engineers) are excluded from the benefits of new § 199A. Of course, the actual operation of new § 199A is considerably more complicated, but the highlights (lowlights?) are as summarized above.

Effective dates. Section 199A applies to taxable years beginning after 2017 and before 2026.

Initial Observations. Our initial, high-level observations of new § 199A are set forth below:

1. *How § 199A applies.* New § 199A is applied at the individual level of any qualifying taxpayer by first requiring a calculation of taxable income excluding the deduction allowed by § 199A and then allowing a special deduction of 20 percent of qualified business income against taxable income to determine a taxpayer's ultimate federal income tax liability. Thus,

the deduction is *not* an above-the-line deduction allowed in determining adjusted gross income; it is a deduction that reduces taxable income. The deduction is available both to those who itemize deductions and those who take the standard deduction. The deduction cannot exceed the amount of the taxpayer's taxable income reduced by net capital gain. The § 199A deduction applies for income tax purposes; it does *not* reduce self-employment taxes. Query what states that piggyback off federal taxable income will do with respect to new § 199A. Presumably, the deduction will be disallowed for state income tax purposes.

2. *Eligible taxpayers.* Section 199A(a) provides that the deduction is available to "a taxpayer other than a corporation." The deduction of § 199A is available to individuals, estates, and trusts. For S corporation shareholders and partners, the deduction applies at the shareholder or partner level. Section 199A(f)(4) directs Treasury to issue regulations that address the application of § 199A to tiered entities.

3. *Qualified trades or businesses (or, what's so special about architect and engineers?)—§ 199A(d).* One component of the § 199A deduction is 20 percent of the taxpayer's qualified business income. To have qualified business income, the taxpayer must be engaged in a qualified trade or business, which is defined as any trade or business *other than* (1) the trade or business of performing services as an employee, or (2) a specified service trade or business. A specified service trade or business is defined (by reference to Code § 1202(e)(3)(A)) as "any trade or business involving the performance of services in the fields of health, … law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees." Architects and engineers must be special, because they are excluded from the definition of a specified service trade or business. There is no reasoned explanation for this exclusion in the 2017 TCJA Conference Report. *Note:* taxpayers whose taxable income, determined without regard to the § 199A deduction, is below a specified threshold are not subject to the exclusion for specified service trades or businesses, i.e., these taxpayers can take the § 199A deduction even if they are doctors, lawyers, accountants etc. The thresholds are $315,000 for married taxpayers filing jointly and $157,500 for all other taxpayers. (These figures will be adjusted for inflation in years beginning after 2018.) Taxpayers whose taxable income exceeds these thresholds are subject to a phased reduction of the benefit of the § 199A deduction until taxable income reaches $415,000 for joint filers and $207,500 for all other taxpayers, at which point the service business cannot be treated as a qualified trade or business.

4. *Qualified business income—§ 199A(c).* One component of the § 199A deduction is 20 percent of the taxpayer's qualified business income, which is generally defined as the net amount from a qualified trade or business of items of income, gain, deduction, and loss included or allowed in determining taxable income. Excluded from the definition are: (1) income not effectively connected with the conduct of a trade or business in the United States, (2) specified investment-related items of income, gain, deduction, or loss, (3) amounts paid to an S corporation shareholder that are reasonable compensation, (4) guaranteed payments to a partner for services, (5) to the extent provided in regulations, payments to a partner for services rendered other than in the partner's capacity as a partner, and (6) qualified REIT dividends, qualified cooperative dividends, or qualified publicly traded partnership income (because these three categories are separate components of the § 199A deduction).

5. *Determination of the amount of the § 199A deduction—§ 199A(a)-(b).* Given the much-touted simplification thrust of the 2017 Tax Cuts and Jobs Act, determining the amount of a taxpayer's § 199A deduction is surprisingly complex. One way to approach the calculation is to think of the § 199A deduction as the sum of three buckets, subject to two limitations. *Bucket 1* is the sum of the following from all of the taxpayer's qualified trades or businesses, determined separately for each qualified trade or business: the lesser of (1) 20 percent of the qualified trade or business income with respect to the trade or business, or (2) the greater of (a) 50 percent of the W–2 wages with respect to the qualified trade or business, or (b) the sum of 25 percent of the W–2 wages with respect to the qualified trade or business, plus 2.5

percent of the unadjusted basis immediately after acquisition of all qualified property. (*Note:* this W-2 wages and capital limitation *does not apply* to taxpayers whose taxable income is below the $157,500/$315,000 thresholds mentioned earlier in connection with the definition of a qualified trade or business. For taxpayers below the thresholds, Bucket 1 is simply 20 percent of the qualified trade or business income. For taxpayers above the thresholds, the wage and capital limitation phases in and fully applies once taxable income reaches $207,500/$415,000.) *Bucket 2* is 20 percent of the sum of the taxpayer's qualified REIT dividends and qualified publicly traded partnership income. *Bucket 3* is the lesser of (1) 20 percent of the taxpayer's qualified cooperative dividends, or (2) the taxpayer's taxable income reduced by net capital gain. *Limitation 1* is that the sum of Bucket 1 and Bucket 2 cannot exceed 20 percent of the amount by which the taxpayer's taxable income exceeds the sum of the taxpayer's net capital gain and qualified cooperative dividends. *Limitation 2* is an overall limitation and provides that the sum of Buckets 1, 2 and 3 (after application of Limitation 1) cannot exceed the amount of the taxpayer's taxable income reduced by the taxpayer's net capital gain. Thus, a taxpayer's § 199A deduction is determined by adding together Buckets 1 and 2, applying Limitation 1, adding Bucket 3, and then applying Limitation 2.

6. *An incentive for business profits rather than wages.* Given a choice, most taxpayers who qualify for the § 199A deduction would prefer to be compensated as an independent contractor (i.e., 1099 contractor) rather than as an employee (i.e., W-2 wages), unless employer-provided benefits dictate otherwise because, to the extent such compensation is "qualified business income," a taxpayer may benefit from the 20 percent deduction authorized by § 199A.

7. *The "Edwards/Gingrich loophole" for S corporations becomes more attractive.* New § 199A exacerbates the games currently played by S corporation shareholders regarding minimizing compensation income (salaries and bonuses) and maximizing residual income from the operations of the S corporation. For qualifying S corporation shareholders, minimizing compensation income not only will save on the Medicare portion of payroll taxes, but also will maximize any deduction available under new § 199A.

5. Unless you fit in one of the exceptions, Congress just increased the interest rate on all your business loans. The 2017 Tax Cuts and Jobs Act, § 13301, amended § 163(j) to limit the deduction for business interest expense. Consequently, if your business is impacted by amended § 163(j), you will pay more for the use of borrowed funds, which is a de facto interest increase. Basically, the deduction for business interest expense under amended § 163(j) will be limited to 30 percent of "adjusted taxable income" (essentially earnings before interest, tax, depreciation and amortization (EBITDA) for the first 4 years, and then earnings before interest and taxes (EBIT) thereafter). Businesses with average annual gross receipts (computed over 3 years) of $25 million or less and businesses in certain industries (notably real estate if a proper election is made, but also floor plan financing of auto dealers and regulated utilities) are exempted from the limitations of amended §163(j). Real estate businesses must accept slightly longer recovery periods by using the alternative depreciation system for certain depreciable property if they elect out of the § 163(j) limitation. Because real estate businesses making the election out must use the alternative depreciation system for so-called qualified improvement property (among other categories), electing out of the § 163(j) limitation would seem to have the effect of making qualified improvement property ineligible for bonus depreciation under § 168(k).

6. To make room for § 199A, Congress repealed the § 199 domestic production activities deduction. We will remember fondly some of the issues it generated, such as whether assembling items into gift baskets constituted "manufacturing." The 2017 Tax Cuts and Jobs Act, § 13305, repealed Code § 199, which granted a special deduction to taxpayers with domestic production activities. The repeal is effective for taxable years beginning after 2017.

7. Violations of law just became a little more expensive. The 2017 Tax Cuts and Jobs Act, § 13306, amended Code § 162(f) to disallow deductions:

> for any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law.

Prior to amendment, § 162(f) stated simply that "[n]o deduction shall be allowed … for any fine or similar penalty paid to a government for the violation of any law." The intent of this provision appears to be to broaden the category of nondeductible items beyond those that might technically constitute a fine or penalty. The amended statute contains exceptions for (1) certain amounts for restitution or remediation (including remediation of property) or to come into compliance with law that are identified as such in a court order or settlement agreement, (2) amounts paid or incurred pursuant to a court order in a suit in which no government or governmental entity is a party, and (3) any amount paid or incurred as taxes due. Payments of restitution for failure to pay taxes that are assessed as restitution in the same manner as a tax qualify for the first exception just listed only if the amounts "would have been allowed as a deduction under this chapter if it had been timely paid." This rule appears to mean that a payment of restitution in a tax case qualifies for the exception only if the taxes would have been deductible if timely paid. The legislation also adds to the Code § 6050X, which requires government agencies to report to the IRS and the taxpayer the amount of each settlement agreement or order entered into where the aggregate amount required to be paid or incurred to or at the direction of the government is at least $600 (or such other amount as may be specified by Treasury). These reports will separately identify any amounts that are for restitution or remediation of property, or correction of noncompliance. The disallowance of deductions and the new reporting requirement apply to amounts paid or incurred on or after December 22, 2017, the date of enactment, but do not apply to amounts paid or incurred under any binding order or agreement entered into before that date.

8. Professional gamblers have a new incentive to fly coach when traveling to a casino: otherwise deductible expenses of a professional gambler are now deductible only to the extent of gains from wagering transactions. Under Code § 165(d), losses from wagering transactions are deductible only to the extent of gains from wagering transactions. Thus, the cost of wagers incurred by an individual are deductible (on Schedule A as an itemized deduction) only to the extent of gambling winnings (reported on the "other income" line of Form 1040). The 2017 Tax Cuts and Jobs Act, § 11050, amended Code § 165(d) by adding a new sentence that reads: "the term 'losses from wagering transactions' includes any deduction otherwise allowable under this chapter incurred in carrying on any wagering transaction." The effect of this amendment is to change the result in *Mayo v. Commissioner*, 136 T.C. 81 (2001), in which the Tax Court held that expenses other than the cost of wagers incurred by a taxpayer engaged in the trade or business of gambling are not subject to the limitation of § 165(d) and instead are deductible as business expenses under § 162(a). Under § 165(d) as amended, costs of a professional gambler, including both the cost of wagers and other costs such as the cost of traveling to a casino, are deductible only to the extent of gambling winnings. This change applies to taxable years beginning after 2017 and before 2026.

- The legislation did not change the deductibility of losses from wagering transactions for non-professional gamblers. Code § 67(g), as amended by the Tax Cuts and Jobs Act, disallowed the deduction of all miscellaneous itemized deductions for taxable years beginning after 2017 and before 2026. Under Code § 67(b)(3), however, the deduction for losses from wagering transactions described in § 165(d) is not a miscellaneous itemized deduction.

9. Businesses will have to allow survivors of sexual harassment and sexual abuse to dish the dirt or else forgo a deduction. The 2017 Tax Cuts and Jobs Act, § 13307, amended Code § 162 by redesignating § 162(q) as § 162(r) and adding new § 162(q), which provides that no deduction is allowed for any settlement, payment, or attorney fees related to sexual harassment or sexual abuse if such payments are subject to a nondisclosure agreement. The provision applies to amounts paid or incurred after the date of enactment, December 22, 2017.

10. Glad-handing local officials is now more expensive: deductions for local lobbying expenses are disallowed. The 2017 Tax Cuts and Jobs Act, § 13308, amended Code § 162(e) by striking § 162(e)(2) and (7) and redesignating the remaining paragraphs accordingly.

Prior to their repeal, § 162(e)(2) and (7) allowed as a deduction costs incurred in carrying on a trade or business to lobby local councils or similar governing bodies, including Indian tribal governments. This change applies to amounts paid or incurred after the date of enactment, December 22, 2017.

11. Standard mileage rates for 2018. Notice 2018-3, 2018-2 I.R.B. 285 (12/14/17). The standard mileage rate for business miles in 2018 goes up to 54.5 cents per mile (from 53.5 cents in 2017) and the medical/moving rate goes up to 18 cents per mile (from 17 cents in 2017). The charitable mileage rate remains fixed by § 170(i) at 14 cents. The portion of the business standard mileage rate treated as depreciation is 25 cents per mile for 2018 (unchanged from 2017).

E. Depreciation & Amortization

1. Certain depreciation and amortization provisions of the 2017 Tax Cuts and Jobs Act:

a. Increased limits and expansion of eligible property under § 179.

Increased § 179 Limits. The 2017 Tax Cuts and Jobs Act, § 13101, increased the maximum amount a taxpayer can deduct under § 179 to $1 million (increased from $520,000). This limit is reduced dollar-for-dollar to the extent the taxpayer puts an amount of § 179 property in service that exceeds a specified threshold. The legislation increased this threshold to $2.5 million (increased from $2,070,000). These changes apply to property placed in service in taxable years beginning after 2017. The legislation did not change the limit on a taxpayer's § 179 deduction for a sport utility vehicle, which remains at $25,000. The basic limit of $1 million, the phase-out threshold of $2.5 million, and the sport utility vehicle limitation of $25,000 all will be adjusted for inflation for taxable years beginning after 2018.

Revised and expanded definition of qualified real property. The 2017 Tax Cuts and Jobs Act, § 13101, also simplified and expanded the definition of "qualified real property," the cost of which can be deducted under § 179 (subject to the applicable limits just discussed). Prior to amendment by the 2017 Tax Cuts and Jobs Act, § 179(f) defined qualified real property as including "qualified leasehold improvement property," "qualified restaurant property," and "qualified retail improvement property." The legislation revised the definition of qualified real property by replacing these three specific categories with a single category, "qualified improvement property" as defined in § 168(e)(6). Section 168(e)(6) defines qualified improvement property (subject to certain exceptions) as "any improvement to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service." In addition, the legislation expands the category of qualified real property by defining it to include the following improvements to nonresidential real property placed in service after the date the property was first placed in service: (1) roofs, (2) heating, ventilation, and air-conditioning property, (3) fire protection and alarm systems, and (4) security systems. These changes apply to property placed in service in taxable years beginning after 2017.

Section 179 property expanded to include certain personal property used to furnish lodging. The 2017 Tax Cuts and Jobs Act, § 13101, also amended Code § 179(d)(1). The effect of this amendment is to include within the definition of § 179 property certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging (such as beds or other furniture, refrigerators, ranges, and other equipment).

b. Goodbye, basis; hello 100 percent § 168(k) bonus first-year depreciation!

100 percent bonus depreciation for certain property. The 2017 Tax Cuts and Jobs Act, § 13201, amended Code § 168(k)(1) and 168(k)(6) to permit taxpayers to deduct 100 percent of the cost of qualified property for the year in which the property is placed in service. This change applies to property *acquired and placed in service* after September 27, 2017, and before 2023. The percentage of the property's adjusted basis that can be deducted is reduced from 100 percent to 80 percent in 2023, 60 percent in 2024, 40 percent in 2025, and 20 percent in 2026. (These periods are extended by one year for certain aircraft and certain property with longer production periods). Property *acquired on or before September 27, 2017* and placed in service after that date is eligible for bonus depreciation of 50 percent if placed in service before 2018, 40 percent if placed in service in 2018, 30 percent if placed in service in 2019, and is ineligible for bonus depreciation if placed in service after 2019.

Used property eligible for bonus depreciation. The legislation also amended Code § 168(k)(2)(A) and (E) to make used property eligible for bonus depreciation under § 168(k). Prior to this change, property was eligible for bonus depreciation only if the original use of the property commenced with the taxpayer. This rule applies to property *acquired and placed in service* after September 27, 2017. Note, however, that used property is eligible for bonus depreciation only if it is acquired "by purchase" as defined in § 179(d)(2). This means that used property is *not* eligible for bonus depreciation if the property (1) is acquired from certain related parties (within the meaning of §§ 267 or 707(b)), (2) is acquired by one component member of a controlled group from another component member of the same controlled group, (3) is property the basis of which is determined by reference to the basis of the same property in the hands of the person from whom it was acquired (such as a gift), or (4) is determined under § 1014 (relating to property acquired from a decedent). In addition, property acquired in a like-kind exchange is not eligible for bonus depreciation.

Qualified property. The definition of "qualified property" eligible for bonus depreciation continues to include certain trees, vines, and plants that bear fruits or nuts (deductible at a 100 percent level for items planted or grafted after September 27, 2017, and before 2023, and at reduced percentages for items planted or grafted after 2022 and before 2027). The definition also includes a qualified film or television production. Excluded from the definition is any property used in a trade or business that has had floor plan financing indebtedness (unless the business is exempted from the § 163(j) interest limitation because its average annual gross receipts over a three-year period do not exceed $25 million).

Section 280F $8,000 increase in first-year depreciation. For passenger automobiles that qualify, § 168(k)(2)(F) increases by $8,000 in the first year the § 280F limitation on the amount of depreciation deductions allowed. The legislation continues this $8,000 increase for passenger automobiles *acquired and placed in service* after 2017 and before 2023. For passenger automobiles acquired *on or before* September 27, 2017, and placed in service after that date, the previously scheduled phase-down of the $8,000 increase applies as follows: $6,400 if placed in service in 2018, $4,800 if placed in service in 2019, and $0 after 2019.

c. Changes to the 280F depreciation limits on passenger automobiles and removal of computer and peripheral equipment from the definition of listed property. The 2017 Tax Cuts and Jobs Act, § 13202, amended Code § 280F(a)(1)(A) to increase the maximum amount of allowable depreciation for passenger automobiles and for which bonus depreciation under § 168(k) is not claimed. The maximum amount of allowable depreciation is $10,000 for the year in which the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years in the recovery period. The legislation also amended § 280F(d)(4) to remove computer or peripheral equipment from the definition of listed property. Both changes apply to property placed in service after 2017 in taxable years ending after 2017.

d. Changes to the depreciation of certain property used in a farming business.

Modifications to the depreciation of farm machinery and equipment. The 2017 Tax Cuts and Jobs Act, § 13203, made two changes with respect to the depreciation of any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) that is used in a farming business. (For this purpose, the term "farming business" is defined in Code § 263A(e)(4).) The legislation amended Code § 168(b)(2) and (e)(3)(B) to repeal the required use of the 150 percent declining balance method and to reduce the recovery period from 7 years to 5 years. Accordingly, such machinery and equipment should be depreciable over 5 years using the double declining balance method and the half-year convention. This change applies to property placed in service after 2017 in taxable years ending after 2017.

Mandatory use of ADS for farming businesses that elect out of the new interest limitation. The 2017 Tax Cuts and Jobs Act, § 13205, amended Code § 168 to add new § 168(g)(1)(G), which requires a farming business that elects out of the newly-enacted interest limitation of § 163(j) to use the alternative depreciation system for any property with a recovery period of 10 years or more. This change applies to taxable years beginning after 2017. **Note:** aside from longer recovery periods, the requirement to use the alternative depreciation system for property with a recovery period of 10 years or more would seem to have the effect of making such property ineligible for bonus depreciation under § 168(k) even if it normally would be eligible for bonus depreciation.

e. Revised definitions and minor adjustments to recovery periods for real property. With respect to real property, the 2017 Tax Cuts and Jobs Act, § 13204, amended Code § 168 to simplify certain definitions and make minor adjustments for purposes of the alternative depreciation system.

Three categories consolidated into one. The legislation replaced the categories of "qualified leasehold improvement property," "qualified restaurant property," and "qualified retail improvement property" with a single category, "qualified improvement property." Code § 168(e)(6) defines qualified improvement property (subject to certain exceptions) as "any improvement to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service." Qualified improvement property is depreciable over 15 years using the straight-line method and is subject to the half-year convention. This change applies to property placed in service after 2017. **Note:** the Conference Agreement indicates that the normal recovery period for qualified improvement property is 15 years, but § 168 as amended does not reflect this change. This should be addressed in technical corrections.

Residential rental property has a 30-year ADS recovery period. The legislation reduced the recovery period for residential rental property for purposes of the alternative depreciation system from 40 years to 30 years. The general recovery period for such property remains at 27.5 years. This change applies to property placed in service after 2017.

Mandatory use of ADS for real property trades or businesses electing out of the new interest limitation. The legislation amended Code § 168 to add new § 168(g)(1)(F) and (g)(8), which require a real property trade or business that elects out of the newly-enacted interest limitation of § 163(j) to use the alternative depreciation system for nonresidential real property, residential rental property, and qualified improvement property. This change applies to taxable years beginning after 2017. **Note:** aside from longer recovery periods, the requirement to use the alternative depreciation system for qualified improvement property would seem to have the effect of making qualified improvement property ineligible for bonus depreciation under § 168(k).

F. Credits

1. A new credit for employers that pay wages to certain employees during periods of family and medical leave. The 2017 Tax Cuts and Jobs Act, § 13403, adds to the Code new § 45S, which provides that an "eligible employer" can include the "paid family and medical leave credit" among the credits that are components of the general business credit under § 38(b). The credit is equal to a percentage of the amount of wages paid to "qualifying employees" during periods in which the employees are on family and medical leave. The credit is available against both the regular tax and the alternative minimum tax.

Amount of the credit. To be eligible for the credit, the employer must pay during the period of leave at a rate that is at least 50 percent of the wages normally paid to the employee. The credit is 12.5 percent of the wages paid, increased by 0.25 percentage points for each percentage point by which the rate of payment exceeds 50 percent. The maximum credit is 25 percent of wages. Thus, if an employer pays an employee at a rate that is 60 percent of the employee's normal wages, the credit is 15 percent of wages paid (12.5 percent plus 2.5 percentage points). The credit reaches 25 percent when the employer pays at a rate that is 100 percent of employee's normal wages. The credit cannot exceed the amount derived from multiplying the employee's normal hourly rate by the number of hours for which the employee takes leave. The compensation of salaried employees is to be prorated to an hourly wage under regulations to be issued by the Treasury Department. The maximum amount of leave for any employee that can be taken into account for purposes of the credit is twelve weeks per taxable year.

Eligible employer. An eligible employer is defined as one who has in place a written policy that (1) allows all full-time "qualifying employees" not less than two weeks of annual paid family and medical leave, and that allows all part-time qualifying employees a commensurate amount of leave on a pro rata basis, and (2) requires that the rate of payment under the program is not less than 50 percent of the wages normally paid to the employee.

Eligible employee. An eligible employee is defined as any employee as defined in section 3(e) of the Fair Labor Standards Act of 1938 who has been employed by the employer for one year or more and who, for the preceding year, had compensation not in excess of 60 percent of the compensation threshold for highly compensated employees. For 2017, the threshold for highly compensated employees (see § 414(q)(1)(B)) was $120,000. Thus, for purposes of determining the credit in 2018, an employee is an eligible employee only if his or her compensation for 2017 did not exceed $72,000 ($120,000 * 60 percent).

Family and medical leave. The term "family and medical leave" is defined as leave described under sections 102(a)(1)(a)-(e) or 102(a)(3) of the Family and Medical Leave Act of 1993. (Generally, these provisions describe leave provided because of the birth or adoption of a child, because of a serious health condition of the employee or certain family members, or because of the need to care for a service member with a serious injury or illness.) If an employer provides paid leave as vacation leave, personal leave, or other medical or sick leave, this paid leave is not considered to be family and medical leave.

No double benefit. The legislation amends Code § 280C(a) to provide that no deduction is allowed for the portion of wages paid to an employee for which this new credit is taken. Thus, if an employer pays $10,000 to an employee and takes a credit for 25 percent, or $2,500, the employer could deduct as a business expense only $7,500 of the wages.

Effective date. The credit is available for wages paid in taxable years beginning after 2017.

G. <u>Natural Resources Deductions & Credits</u>

H. <u>Loss Transactions, Bad Debts, and NOLs</u>

1. Those NOLs are not worth what they used to be (at least until 2026). The 2017 Tax Cuts and Jobs Act, § 11012, amended § 461 by adding § 461(l), which disallows "excess business losses" for noncorporate taxpayers for taxable years beginning in 2018. Such "excess business losses" are determined after application of the passive loss rules of § 469. Essentially, as the authors read the statute, losses disallowed for a taxable year under § 461(l) are carried over to the next taxable year and become NOL carryforwards subject to revised § 172(a) (discussed below). Thus, the practical effect of § 461(l) appears to be a one-year deferral of "excess business losses." An "excess business loss" is defined as the amount by which a noncorporate taxpayer's aggregate trade or business deductions exceed aggregate gross income from those trades or businesses, plus $250,000 ($500,000 for joint filers). The term "aggregate trade or business deductions" apparently does not include § 172 carryforwards, so NOLs carried forward from 2017 and prior taxable years are not limited by new § 461(l). Such carryforwards are, however, limited by the changes made to § 172(a) (as discussed below). For partnerships and S corporations, new § 461(l) applies at the partner or shareholder level, and for farmers, the prior limitation on "excess farm losses" under § 461(j) is suspended so that only § 461(l) applies to limit such losses. After 2018, the cap on "excess business losses" is adjusted annually for inflation. Mercifully, new § 461(l) sunsets for taxable years beginning on or after January 1, 2026.

a. Surely you jest . . . there's even more bad news for NOLs? The **2017 Tax Cuts and Jobs Act**, § 13302(a), amended § 172(a) such that, for taxable years beginning in 2018, NOLs (except "farming losses" and NOLs of non-life insurance companies) no longer may be carried back two years, and any carried forward NOLs are capped at 80 percent of taxable income (computed without regard to NOLs). This change to § 172(a) is permanent.

b. The good news: NOLs now are like BFFs; they stick with you until you die! The **2017 Tax Cuts and Jobs Act**, § 13302(b), amended § 172(b)(1)(A)(ii) so that NOLs may be carried forward indefinitely (except by non-life insurance companies) rather than being limited to 20 years as under pre-TCJA law. This change to § 172(b) is permanent.

I. At-Risk and Passive Activity Losses

III. INVESTMENT GAIN

A. Gains and Losses

B. Interest, Dividends, and Other Current Income

C. Profit-Seeking Individual Deductions

1. Say it isn't so! Miscellaneous itemized deductions are no longer deductible beginning in 2018. The 2017 Tax Cuts and Jobs Act, § 11045, amended Code § 67 by adding § 67(g), which disallows as deductions all miscellaneous itemized deductions for taxable years beginning after 2017 and before 2026. Miscellaneous itemized deductions are defined in § 67(b) and, prior to the Tax Cuts and Jobs Act, were deductible to the extent that, in the aggregate, they exceeded 2 percent of the taxpayer's adjusted gross income. The largest categories of miscellaneous itemized deductions are: (1) investment-related expenses such as fees paid for investment advice or for a safe deposit box used to store investment-related items, (2) unreimbursed employee business expenses, and (3) tax preparation fees.

D. Section 121

E. Section 1031

1. When it comes to like-kind exchanges, President Trump, qualified exchange intermediaries, and non-dealers in real estate are winners, but those exchanging airplanes, earth movers, and other large equipment are "losers." The 2017 Tax Cuts and Jobs Act, § 13303, amended § 1031(a)(1) so that the term "real property" is substituted for "property" for taxable years beginning after 2017. Pre-TCJA § 1031(e) (livestock of different sexes), (i) (mutual ditch, reservoir, or irrigation company stock), and (h)(2) (U.S. and non-U.S. personal property) are repealed. In effect, then, like-kind exchanges under § 1031 for 2018 and future years are limited to real property. New § 1031(e) provides that if under § 761(a) a partnership elects out of subchapter K, then an interest in such a partnership is treated for purposes of § 1031 as "an interest in each of the assets of such partnership and not as an interest in a partnership." The changes to § 1031 are permanent. Nevertheless, a transition rule (TCJA § 13303(c)) allows any forward or reverse exchange that began under § 1031 before 2018 to qualify for nonrecognition if completed after December 31, 2017 (assuming, of course, that all other requirements of § 1031 are met).

F. Section 1033

G. Section 1035

H. Miscellaneous

1. A self-created patent, invention, model or design, secret formula or process is excluded from the definition of a capital asset. The 2017 Tax Cuts and Jobs Act, § 13314, amended Code § 1221(a)(3) to expand the types of self-created property that are excluded from the definition of a capital asset. Prior to amendment by the Tax Cuts and Jobs Act, Code § 1221(a)(3) excluded from the definition of a capital asset "a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by" a taxpayer whose personal efforts created the property or (in the case of a letter, memorandum, or similar property) a taxpayer for whom the property was produced. This same property is excluded from the capital asset category if it is held by a taxpayer whose basis in the property is determined by reference to the basis of the person who created it or for whom it was created (e.g., a taxpayer who acquired the property from the creator as a gift). The legislation adds to the list of property subject to this rule "a patent, invention, model or design (whether or not patented), a secret formula or process." A conforming amendment to Code § 1231(b)(1)(C) excludes this same property from the definition of "property used in a trade or business" for purposes of § 1231. Thus, a self-created patent, model or design, secret formula or process is not a capital asset and is not subject to § 1231. The effect of this provision is to treat gain or loss from the sale or disposition of these assets as ordinary. This rule applies to dispositions after 2017.

- The legislation creates an unresolved conflict between amended § 1221(a)(3), on the one hand, and § 1235, on the other. Section 1235(a) provides that a transfer (other than by gift, inheritance, or devise) by a "holder" of property consisting of all substantial rights to a patent or an undivided interest in a patent is treated as the sale or exchange of a capital asset held for more than one year. This is true regardless of whether payments received by the transferor are payable periodically as the transferee uses the patent or are contingent on the productivity, use, or disposition of the property transferred. The term "holder" includes an individual whose efforts created the property. Thus, if an individual whose personal efforts created a patent sells the patent, § 1235 dictates that the gain is long-term capital gain and § 1221(a)(3) dictates that the patent is not a capital asset. In our view, § 1235 should take priority because it essentially says that gain from the sale of a self-created patent is long-term capital gain and does not make this result contingent on the patent's status as a capital asset. This conflict is likely the result of a legislative oversight. The House version of the legislation would have amended § 1221(a)(3) and would have repealed § 1235. The final version of the legislation amended § 1221(a)(3) but left § 1235 in place.

IV. COMPENSATION ISSUES

A. Fringe Benefits

1. Meals provided for the convenience of the employer will not be deductible beginning in 2026. The 2017 Tax Cuts and Jobs Act, § 13304, amended Code § 274 by adding § 274(o), which disallows as deductions meals provided for the convenience of the employer (within the meaning of § 119), which otherwise would be deductible by the employer. This rule applies to amounts paid or incurred after 2025.

2. The Tax Court ices the IRS by allowing the Boston Bruins' 100% deduction for away-game meals as a *de minimis* fringe, while the winning slap shot may be that hotel and banquet facilities can be "leased." Jacobs v. Commissioner, 148 T.C. No. 24 (6/26/17). The taxpayers, a married couple, own the S corporation that operates the Boston Bruins professional hockey team. When the Bruins travel to away games, the team provides the coaches, players, and other team personnel with hotel lodging as well as pre-game meals in private banquet rooms. Game preparation (e.g., strategy meetings, viewing films, discussions among coaches and players) also takes place during these team meals. The Bruins enter into extensive contracts with away-game hotels, including terms specifying the food to be served and how the banquet rooms should be set up. The taxpayers' S corporation spent approximately $540,000 on away-game meals at hotels over the years 2009 and 2010, deducting the full amount thereof pursuant to §§ 162, 274(n)(2)(B), and 132(e). Section 274(n) generally disallows 50 percent of meal and entertainment expenses, but § 274(n)(2)(B) provides an exception if the expense qualifies as a *de minimis* fringe benefit under § 132(e). Under Reg. § 1.132–7, employee meals provided on a nondiscriminatory basis qualify under § 132(e) if (1) the eating facility is owned or leased by the employer; (2) the facility is operated by the employer; (3) the facility is located on or near the business premises of the employer; (4) the meals furnished at the facility are provided during, or immediately before or after, the employee's workday; and (5) the annual revenue derived from the facility normally equals or exceeds the direct operating costs of the facility. The IRS argued that the Bruins' expenses do not qualify under § 132(e) and thus should be limited to 50 percent under § 274(n) because meals at away-game hotels are neither at facilities "operated by the employer," nor "owned or leased by the employer," nor "on or near the business premises of the employer." After easily determining that the other requirements for *de minimus* fringe benefit treatment were met, the Tax Court (Judge Ruwe) focused upon whether, for purposes of § 132(e) and Reg. § 1.132-7, the Bruins' away-game hotels can be considered facilities that are "operated by the employer," "leased by the employer," and "on or near the business premises of the employer." Judge Ruwe held that because away-game travel and lodging are indispensable to professional hockey and because the Bruins' contracts with the hotels specify many of the details regarding lodging, meals, and banquet rooms, the meal expenses are 100 percent deductible as a *de minimis* fringe. The hotel facilities are "operated by the employer" because the regulations expressly construe that term to include being operated under contract with the employer.

The hotel facilities also should be considered "leased" by the employer, the court concluded, due to the extensive contracts and the team's exclusive use and occupancy of designated hotel space. Further, the court concluded that, because away-game travel and lodging is an indispensable part of professional hockey, the hotel facilities should be considered the business premises of the employer.

- **The slap shot to the IRS:** The Tax Court's holding that the Bruins' "lease" the hotel facilities is somewhat at odds with regulations under § 512. Reg. § 1.512(b)-1(c)(5) provides that amounts received for the use or occupancy of space where personal services are rendered to the occupant (e.g., hotel services) does not constitute rent for purposes of the § 512 exclusion from unrelated business taxable income. *See also* Rev. Rul. 80-298, 1980-2 C.B.197 (amounts received by tax-exempt university for professional football team's use of playing field and dressing room along with maintenance, linen, and security services is not rental income for purposes of § 512 exclusion from UBTI). Judge Ruwe's decision may embolden tax-exempt organizations seeking to exclude so-called "facility use fees" (e.g., payments made to an aquarium for exclusive use of its space for corporate events) from UBTI.

a. **But wait, upon further consultation with the replay center, the call is reversed!** The 2017 Tax Cuts and Jobs Act, § 13304, amends Code § 274(n) to remove the exception to the 50 percent limitation for meal expenses that qualify as a *de minimis* fringe benefit. Accordingly, employers can deduct only 50 percent of the cost of employee meals provided at an employer-operated eating facility. This rule applies to amounts paid or incurred after 2017 and before 2026. Beginning in 2026, such costs are *entirely disallowed* as deductions pursuant to new Code § 274(o).

3. **Are we really so strapped for cash that we have to tax people who ride their bicycles to work?** The 2017 Tax Cuts and Jobs Act, § 11047, amends Code § 132(f) by adding § 132(f)(8), which provides that the exclusion from gross income provided by § 132(f)(1)(D) for qualified bicycle commuting reimbursements provided by employers shall not apply to any taxable year beginning after 2017 and before 2026.

4. **Those who move for work-related reasons now have a higher tax bill. Is this really good for the economy?** Provided that certain requirements are met, Code § 217 allows a taxpayer to deduct moving expenses paid or incurred in connection with the taxpayer's commencement of work (either as an employee or as a self-employed individual) at a new principal place of work. Section 132(g) of the Code excludes from an employee's gross income a "qualified moving expense reimbursement," defined as an employer's reimbursement of moving expenses that, if paid by the employee, would be deductible under § 217. The 2017 Tax Cuts and Jobs Act amended both provisions. Section 11049 of the TCJA amended Code § 217 by adding § 217(k), which provides that the deduction for moving expenses shall not apply to any taxable year beginning after 2017 and before 2026. Section 11048 of the TCJA amended Code § 132(g) by adding § 132(g)(2), which provides that the exclusion from gross income for a qualified moving expense reimbursement shall not apply to any taxable year beginning after 2017 and before 2026. Both amendments contain an exception for members of the armed forces on active duty who move pursuant to a military order and incident to a permanent change of station, i.e., such individuals can still deduct moving expenses and exclude moving expense reimbursements.

B. Qualified Deferred Compensation Plans

C. Nonqualified Deferred Compensation, Section 83, and Stock Options

1. **Employees of privately owned corporations can elect to defer income from "qualified equity grants" for up to five years.** The 2017 Tax Cuts and Jobs Act, § 13603, amended Code § 83 by adding § 83(i), which allows a "qualified employee" to elect to defer income attributable to "qualified stock" transferred to the employee by the employer. The election must be made no later than 30 days after the first time the employee's right to the stock is substantially vested or is transferable, whichever occurs earlier. Generally, the effect of this provision is to allow the employee to defer including in income the amount that the employee normally would be required to include under the rules of § 83(a). Under the rules of § 83(h), the employer's deduction for the value of the stock should be deferred until the employee includes the value in gross income. If the

employee does *not* make the § 83(i) election, then the normal rules of § 83 apply. If the employee *does* make the § 83(i) election, then the employee must include in gross income the amount determined under § 83(a) (normally the fair market value of the stock less whatever the employee paid for it, *determined when the rights of the employee in the stock first become transferable or not subject to substantial risk of forfeiture*) upon the first to occur of the following: (1) the first date the qualified stock becomes transferable (including transferable to the employer); (2) the date the employee first becomes an "excluded employee;" (3) the first date on which any stock of the employer becomes readily tradable on an established securities market; (4) the date five years after the first date the employee's right to the stock becomes substantially vested; or (5) the date on which the employee revokes his or her election. The statute contains many definitions. A "qualified employee" generally is any employee other than an "excluded employee." Excluded employees are defined as a 1 percent owners (currently or during the ten preceding calendar years), those who have been at any prior time the Chief Executive Officer or the Chief Financial Officer, and those who are one of the four highest compensated officers (currently or during any of the ten preceding taxable years) determined on the basis of the shareholder disclosure rules for compensation under the Securities Exchange Act of 1934. "Qualified stock" is generally defined as stock transferred by an "eligible corporation" that is an employer of an employee in connection with the employee's performance of services if the employee receives the stock either in connection with the exercise of an option or in settlement of a restricted stock unit. A corporation is an "eligible corporation" if (1) no stock of the corporation (or any predecessor) is readily tradable on an established securities market during any preceding calendar year, and (2) the corporation has a written plan under which not less than 80 percent of all employees who provide services to the corporation in the United States (or any U.S. possession) are granted stock options, or are granted restricted stock units, with the same rights and privileges to receive qualified stock. A corporation that transfers qualified stock to an employee must provide notice to the employee that the stock is qualified stock and that the employee may be eligible to elect to defer income on such stock. This provision applies to options exercised, or restricted stock units settled, after 2017

D. Individual Retirement Accounts

1. **We can no longer unwind Roth conversions if the market goes down.** The 2017 Tax Cuts and Jobs Act, § 13611, amended Code § 408A(d)(6)(B) by adding § 408A(d)(6)(B)(iii), which prohibits recharacterizing conversion contributions to a Roth IRA as made to a traditional IRA. This change still permits conversions of a traditional IRA to a Roth IRA (and therefore still permits so-called back-door Roth IRAs), but prohibits recharacterizing the conversion by the October 15 extended due date for individual returns. This change therefore precludes an individual from deciding to unwind a Roth conversion by the extended due date of the individual's return based on market performance. The provision applies to taxable years beginning after 2017.

V. PERSONAL AND INDIVIDUAL INCOME AND DEDUCTIONS

A. Rates

1. **Under the new, simplified rate structure of the 2017 Tax Cuts and Jobs Act, the number of individual rate brackets has been reduced from seven to seven.** The 2017 Tax Cuts and Jobs Act, § 11001(a), added Code § 1(j), which replaces the existing rate structure for ordinary income of individuals with a new rate structure for taxable years beginning after 2017 and before 2026. Unless Congress takes further action, the existing rate structure, as adjusted for inflation, will apply once more for taxable years beginning after 2025. The following tables show the rate structure for individuals that had been scheduled to take effect for taxable years beginning in 2018 and the rate structure that will apply by virtue of the 2017 Tax Cuts and Jobs Act. The brackets established by the 2017 Tax Cuts and Jobs Act will be adjusted for inflation for tax years beginning after 2018.

2018 Rates for Single Individuals		If taxable income is:	Then income tax equals:
1	*Before TCJA*	Not over $9,525	10% of taxable income
	After TCJA	Not over $9,525	10% of taxable income
2	*Before TCJA*	Over $9,525 but not over $38,700	$952.50 plus 15% of the excess over $9,525
	After TCJA	Over $9,525 but not over $38,700	$952.50, plus 12% of the excess over $9,525
3	*Before TCJA*	Over $38,700 but not over $93,700	$5,328.75 plus 25% of the excess over $38,700
	After TCJA	Over $38,700 but not over $82,500	$4,453.50, plus 22% of the excess over $38,700
4	*Before TCJA*	Over $93,700 but not over $195,450	$19,078.75 plus 28% of the excess over $93,700
	After TCJA	Over $82,500 but not over $157,500	$14,089.50, plus 24% of the excess over $82,500
5	*Before TCJA*	Over $195,450 but not over $424,950	$47,568.75 plus 33% of the excess over $195,450
	After TCJA	Over $157,500 but not over $200,000	$32,089.50, plus 32% of the excess over $157,500
6	*Before TCJA*	Over $424,950 not over $426,700	$123,303.75 plus 35% of the excess over $424,950
	After TCJA	Over $200,000 but not over $500,000	$45,689.50, plus 35% of the excess over $200,000
7	*Before TCJA*	Over $426,700	$123,916.25 plus 39.6% of the excess over $426,700
	After TCJA	Over $500,000	$150,689.50, plus 37% of the excess over $500,000

2018 Rates for Married Individuals Filing Joint Returns and Surviving Spouses		If taxable income is:	Then income tax equals:
1	*Before TCJA*	Not over $19,050	10% of taxable income
	After TCJA	Not over $19,050	10% of taxable income
2	*Before TCJA*	Over $19,050 but not over $77,400	$1,905 plus 15% of the excess over $19,050
	After TCJA	Over $19,050 but not over $77,400	$1,905, plus 12% of the excess over $19,050
3	*Before TCJA*	Over $77,400 but not over $156,150	$10,657.50 plus 25% of the excess over $77,400
	After TCJA	Over $77,400 but not over $165,000	$8,907, plus 22% of the excess over $77,400
4	*Before TCJA*	Over $156,150 but not over $237,950	$30,345 plus 28% of the excess over $156,150
	After TCJA	Over $165,000 but not over $315,000	$28,179, plus 24% of the excess over $165,000
5	*Before TCJA*	Over $237,950 but not over $424,950	$53,249 plus 33% of the excess over $237,950
	After TCJA	Over $315,000 but not over $400,000	$64,179, plus 32% of the excess over $315,000
6	*Before TCJA*	Over $424,950 but not over $480,050	$114,959 plus 35% of the excess over $424,950

	After TCJA	Over $400,000 but not over $600,000	$91,379, plus 35% of the excess over $400,000
7	*Before TCJA*	Over $480,050	$134,244 plus 39.6% of the excess over $480,050
	After TCJA	Over $600,000	$161,379, plus 37% of the excess over $600,000

2. The rates of tax on net capital gains and qualified dividends remain essentially the same under the 2017 Tax Cuts and Jobs Act. The 2017 Tax Cuts and Jobs Act, § 11001(a), added Code § 1(j). For taxable years beginning after 2017, and before 2026, § 1(j)(5) retains the existing maximum rates of tax on net capital gains and qualified dividends. Thus, the maximum rates of tax on adjusted net capital gain remain at 0 percent, 15 percent, or 20 percent. The maximum rate of tax on unrecaptured section 1250 gain remains at 25 percent, and the maximum rate on 28-percent rate gain remains at 28 percent. Further, the 3.8 percent tax on net investment income remains in place. However, unlike current law, which determines the rate of tax on adjusted net capital gain by reference to the rate of tax that otherwise would be imposed on the taxpayer's taxable income (including the adjusted net capital gain), new § 1(j)(5) defines "breakpoints" that are used for this purpose. The breakpoints are those under the current rate structure (before amendment by the 2017 Tax Cuts and Jobs Act) but are adjusted for inflation for taxable years beginning after 2017. For taxable years beginning in 2018, the following table shows the breakpoints that establish the rate of tax on adjusted net capital gain.

2018 Rates of Tax on Adjusted Net Capital Gain					
Tax Rate	**Single**	**Head of Household**	**Married Filing Jointly**	**Married Filing Separately**	**Estates and Trusts**
0% if taxable income does not exceed	$38,600	$51,700	$77,200	$38,600	$2,600
15% if taxable income does not exceed	$425,800	$452,400	$479,000	$239,500	$12,700
20% if taxable income exceeds	$425,800	$452,400	$479,000	$239,500	$12,700

3. An incentive for kids to be entrepreneurial? The Tax Cuts and Jobs Act modified the kiddie tax by applying the rates of tax applicable to trusts and estates to the unearned income of children. The 2017 Tax Cuts and Jobs Act, § 11001(a), added Code § 1(j). For taxable years beginning after 2017 and before 2026, § 1(j)(4) modifies the so-called "kiddie tax" by taxing the unearned income of children under the rate schedule that applies to trusts and estates. (The earned income of children continues to be taxed at the rates that normally apply to a single individual.) This changes the approach of current law, under which the tax on unearned income of children is determined by adding it to the income of the child's parents and calculating a hypothetical increase in tax for the parents. Under the new approach, the child's tax on unearned income is unaffected by the parents' tax situation. The 2017 Tax Cuts and Jobs Act does not change the categories of children subject to the kiddie tax.

B. <u>Miscellaneous Income</u>

1. Provisions of the 2017 Tax Cuts and Jobs Act that affect ABLE accounts.

a. Designated beneficiaries of ABLE accounts can contribute an additional amount and are eligible for the saver's credit. Code § 529A, enacted by the Stephen Beck, Jr., Achieving a Better Life Experience (ABLE) Act of 2014 (which became Division A of the

Tax Increase Prevention Act of 2014), provides a tax-favored savings account for certain individuals with disabilities—the ABLE account. ABLE accounts permit certain individuals who became disabled before reaching age 26 and their families to contribute amounts to meet expenses related to the designated beneficiary's disability without affecting the beneficiary's eligibility for Supplemental Security Income, Medicaid, and other public benefits. ABLE accounts are modeled on § 529 accounts that are used to save for college education. Like § 529 accounts, ABLE accounts must be established pursuant to a state program, contributions to ABLE accounts are not tax deductible, the earnings of the ABLE account are not subject to taxation, and distributions from ABLE accounts are not included in the designated beneficiary's income to the extent they are used for qualified expenses related to the disability. Aggregate contributions to an ABLE account from all contributors cannot exceed the annual per-donee gift tax exclusion ($15,000 in 2018). The 2017 Tax Cuts and Jobs Act, § 11024, amended Code § 529A to increase this contribution limit for contributions made before 2026. Under the increased limit, once the overall limitation on contributions is reached, an ABLE account's designated beneficiary who is an employee (as defined) can contribute an additional amount equal to the lesser of: (1) the compensation includible in the beneficiary's income for the year, or (2) the federal poverty line for a one-person household as determined for the immediately preceding year ($12,486 for a single individual under age 65 in 2016). A designated beneficiary is considered to be an employee for this purpose only if the person is an employee with respect to whom no contribution is made to a defined contribution plan, an annuity contract described in § 403(b), or an eligible deferred compensation plan described in § 527. The legislation also makes designated beneficiaries of ABLE accounts who contribute eligible for the saver's credit of § 25B for contributions made before 2026. Both amendments are effective for taxable years beginning after December 22, 2017, the date of enactment.

b. Tax-free rollovers are permitted from a § 529 college savings account to an ABLE account. The 2017 Tax Cuts and Jobs Act, § 11025, amends Code § 529 to permit amounts in a § 529 account to be rolled over without penalty to an ABLE account if the owner of the ABLE account is the designated beneficiary of the § 529 account or a member of the designated beneficiary's family. Amounts rolled over pursuant to this provision, together with any other contributions to the ABLE account, are taken into account for purposes of the limit on aggregate contributions to the ABLE account. Any amount rolled over that exceeds this limitation is included in the gross income of the distributee in the manner provided by § 72. This provision applies to distributions from a § 529 account after December 22, 2017 (the date of enactment) that are transferred within 60 days and before 2026 to an ABLE account.

2. A new exclusion for cancellation of student loans on account of the death or permanent disability of the student. The 2017 Tax Cuts and Jobs Act, § 11031, amended Code § 108(f) by adding § 108(f)(5), which excludes from a taxpayer's gross income any amount which would be included in gross income by reason of the discharge of a student loan if the loan is discharged on account of the death or total and permanent disability of the student. For this purpose, the term "student loan" has the meaning set forth in § 108(f)(2) (which describes loans made by the federal or a state government or any political subdivision as well as loans made by certain public benefit corporations and educational organizations), and also includes private educational loans as defined in Consumer Credit Protection Act § 140(7). This exclusion applies to discharges of indebtedness occurring after 2017 and before 2026.

C. Hobby Losses and § 280A Home Office and Vacation Homes

D. Deductions and Credits for Personal Expenses

1. Standard deduction for 2018. The 2017 Tax Cuts and Jobs Act, § 11021, added Code § 63(c)(7), which significantly increases the standard deduction for taxable years beginning after 2017 and before 2026. This change, combined with the legislation's limitation or elimination of many itemized deductions, is expected to cause a large number of taxpayers who have itemized deductions in prior years to take the standard deduction beginning in 2018. The standard deduction for 2018 will be $24,000 for joint returns and surviving spouses (increased from $13,000), $12,000 for unmarried individuals and married individuals filing separately (increased from $6,500), and

$18,000 for heads of households (increased from $9,550). These figures will be adjusted for inflation for tax years beginning after 2018.

2. Let's hope new withholding tables are issued soon. The deduction for personal exemptions has disappeared. The 2017 Tax Cuts and Jobs Act, § 11041, amended Code § 151(d) by adding § 151(d)(5), which reduces the exemption amount to zero for taxable years beginning after 2017 and before 2026. The effect of this amendment is to eliminate the deduction for personal exemptions. The reduction of the exemption amount to zero required conforming amendments to other Code provisions that make use of the exemption amount. For example, under § 6012, an individual taxpayer generally does not need to file a return if the taxpayer's gross income does not exceed the sum of the basic standard deduction plus the exemption amount under § 151(d). The legislation addresses this by amending § 6012 to provide that an individual need not file a return if the taxpayer's gross income does not exceed the standard deduction. Similarly, § 642(b)(2)(C) allows a qualified disability trust to deduct an amount equal to the exemption amount under § 151(d), and § 6334(d) exempts from levy an amount of weekly wages equal to 1/52 of the sum of the standard deduction and the aggregate amount of the taxpayer's deductions for personal exemptions under § 151. The legislation addresses this issue by amending those provisions to refer to $4,105 (to be adjusted for inflation), the exemption amount that had been scheduled to take effect in 2018 before the Tax Cuts and Jobs Act. The legislation also directs Treasury to develop rules to determine the amount of tax that employers are required to withhold from an employee's wages but gives Treasury the discretion to apply current wage withholding rules for 2018.

3. Has the federal deduction for your high property or state income taxes made them easier to bear? Brace yourself! The deduction for state and local taxes not paid or accrued in carrying on a trade or business or an income-producing activity is limited to $10,000. The 2017 Tax Cuts and Jobs Act, § 11042, amended Code § 164(b) by adding § 164(b)(6). For individual taxpayers, this provision generally (1) eliminates the deduction for foreign real property taxes, and (2) limits to $10,000 ($5,000 for married individuals filing separately) a taxpayer's itemized deductions on Schedule A for the aggregate of state or local property taxes, income taxes, and sales taxes deducted in lieu of income taxes. This provision applies to taxable years beginning after 2017 and before 2026. The provision does *not* affect the deduction of state or local property taxes or sales taxes that are paid or accrued in carrying on a trade or business or an income-producing activity (i.e., an activity described in § 212) that are properly deductible on Schedules C, E, or F. For example, property taxes imposed on residential rental property will continue to be deductible. With respect to income taxes, an individual can deduct only *foreign* income taxes paid or accrued in carrying on a trade or business or an income-producing activity. As under current law, an individual cannot deduct state or local income taxes as a business expense even if the individual is engaged in a trade or business as a sole proprietor. *See* Reg. § 1.62-1T(d).

4. Better be careful with that cash-out refinance. You could wind up with home equity indebtedness, the interest on which is no longer deductible. And there's more good news: the limit on acquisition indebtedness has dropped to $750,000. Prior to the 2017 Tax Cuts and Jobs Act, Code § 163(a) and (h)(3) allowed a taxpayer to deduct as an itemized deduction the interest on up to $1 million of acquisition indebtedness and up to $100,000 of home equity indebtedness. Acquisition indebtedness is defined as indebtedness secured by a qualified residence that is incurred to acquire, construct, or substantially improve the residence. Home equity indebtedness is defined as any indebtedness secured by a qualified residence that is not acquisition indebtedness. The Tax Cuts and Jobs Act, § 11043, amended § 163(h)(3) by adding § 163(h)(3)(F). For taxable years beginning after 2017 and before 2026, § 163(h)(3)(F) disallows the deduction of interest on home equity indebtedness and limits the amount of debt that can be treated as acquisition indebtedness to $750,000 ($375,000 for married taxpayers filing separately). There is no transition rule for home equity indebtedness. Therefore, the interest on any outstanding home equity indebtedness will become nondeductible beginning in 2018. The provision contains three transition rules that might affect acquisition indebtedness: (1) the new $750,000 limit on acquisition indebtedness does not apply to debt incurred on or before December 15, 2017; (2) any refinancing of indebtedness is treated for purposes of the December 15, 2017, transition date as incurred on the date that the original indebtedness was incurred to the extent the amount of the new indebtedness does not exceed the amount of the refinanced indebtedness (but this rule applies only for the term of the original indebtedness); and (3) a taxpayer who entered into a written, binding contract before December 15, 2017, to close on the purchase of a principal residence before January 1, 2018, and who purchases the residence before April 1, 2018 with indebtedness is considered to have incurred acquisition indebtedness prior to December 15, 2017.

- These rules could have an unanticipated effect on taxpayers who engage in a cash-out refinancing of existing acquisition indebtedness. If the amount of the new loan that exceeds the refinanced loan (i.e., the cash-out) is used for purposes unrelated to the home, that portion of the loan will be home equity indebtedness, the interest on which will not be deductible. For example, if a taxpayer refinances $100,000 of acquisition indebtedness by taking out a new loan of $110,000 and using the extra $10,000 to pay off high-interest credit card debt, the extra $10,000 will be home equity indebtedness and the interest on that portion of the loan will not be deductible.

5. Expansion of the 7.5 percent threshold for deduction of medical expenses. Prior to the 2017 Tax Cuts and Jobs Act, medical expenses generally were deductible only to the extent they exceeded 10 percent of a taxpayer's adjusted gross income. For taxable years beginning after 2012 and ending before 2017, this threshold was reduced to 7.5 percent if the taxpayer or the taxpayer's spouse had attained age 65 by the close of the year. The 2017 Tax Cuts and Jobs Act, § 11027, amended § 213(f) to provide that the 7.5 percent threshold applies to all taxpayers for taxable years beginning after 2016 and ending before 2019, i.e., to calendar years 2017 and 2018. Further, the legislation provides that this threshold applies for purposed of both the regular tax and the alternative minimum tax.

6. An increased incentive to purchase insurance: say goodbye to the deduction for personal casualty losses (except those in federally declared disaster areas). The 2017 Tax Cuts and Jobs Act, § 11044, amended Code § 165(h) by adding § 165(h)(5), which eliminates the deduction for personal casualty losses, other than those attributable to a federally declared disaster, for taxable years beginning after 2017 and before 2026. Despite this general disallowance, the legislation permits taxpayers to offset the amount of any personal casualty gains by the amount of otherwise-disallowed personal casualty losses.

7. ♪♫I keep on fallin' in and out of love with you.♫♪ Congress has repealed the § 68 overall limitation on overall deductions again. The 2017 Tax Cuts and Jobs Act, § 11046, amended Code § 68 by adding § 68(f), which provides that the overall limitation on itemized deductions does not apply to taxable years beginning after 2017 and before 2026. This limitation reduces the amount of most itemized deductions by the lesser of 3 percent of the amount by which the taxpayer's adjusted gross income exceeds a specified threshold, or 80 percent of the itemized deductions. Congress first enacted this limitation as part of the Omnibus Budget Reconciliation Act of 1990. In the Economic Growth and Tax Relief Reconciliation Act of 2001, Congress repealed § 68 prospectively on a phased reduction schedule beginning in 2006, with full repeal effective for taxable years beginning after 2009. The provision did not apply in taxable years 2010 through 2012. Congress reinstated § 68 in the American Taxpayer Relief Act of 2012 for taxable years beginning after 2012. The provision was in effect for taxable years 2013 through 2017, and now has been repealed once more.

8. An enhanced child tax credit. The 2017 Tax Cuts and Jobs Act, § 11022, added Code § 24(j), which significantly increases the child tax credit and establishes a new credit for dependents other than qualifying children for taxable years beginning after 2017 and before 2026.

Child Tax Credit. The legislation increases the child tax credit from $1,000 to $2,000 per qualifying child and increases the refundable portion of the credit from $1,000 to $1,400 per qualifying child. The $1,400 refundable portion of the credit will be adjusted for inflation for taxable years beginning after 2018. The legislation retains the current-law age limit for the credit, i.e., a person can be a qualifying child only if he or she has not attained age 17 by the end of the taxable year. The refundable portion of the credit is determined in the same manner as under current law, except that the earned income threshold for determining the refundable portion is reduced from $3,000 to $2,500. To claim the child tax credit (either the refundable or nonrefundable portion), a taxpayer must include on the return for each qualifying child with respect to whom the credit is claimed a Social Security Number that was issued before the due date for filing the return. If the child tax credit is not available with respect to a qualifying child because of the absence of a Social Security Number, the taxpayer can claim the new, nonrefundable credit described below with respect to that child.

New Nonrefundable Credit for Dependents Other Than a Qualifying Child. The legislation also makes available (as an increase to the basic child tax credit) a new, nonrefundable credit of $500 for each dependent other than a qualifying child. This new credit would apply, for example, with respect to a parent who is the taxpayer's dependent and therefore a qualifying relative. The new, nonrefundable credit is available only with respect to a dependent who is a citizen, national, or resident of the U.S., i.e., the credit is not available with respect to a dependent who is a resident of the contiguous countries of Canada and Mexico.

Increased Phase-out Thresholds. The legislation significantly increases the modified adjusted gross income thresholds at which the credits (both the child tax credit and the new nonrefundable credit) begin to phase out. Under current law, the child tax credit is phased out by $50 for each $1,000 by which the taxpayer's modified AGI exceeds $55,000 for married taxpayers filing separately, $75,000 for single taxpayers or heads of household, and $110,000 for married taxpayers filing a joint return. Thus, under current law, the credit is phased out entirely for married taxpayers filing a joint return once modified AGI reaches $130,000. The legislation increases the phase-out thresholds to $400,000 for married couples filing a joint return and $200,000 for all other taxpayers. These increased thresholds will increase the number of taxpayers who benefit from the credit.

E. Divorce Tax Issues

1. **♪♫Breaking up is hard to do.♫♪ But, if you have been thinking about it, split up in 2018 if you want to save taxes. Under the Tax Cuts and Jobs Act, alimony is not deductible by the payor and is not taxable for the recipient.** The 2017 Tax Cuts and Jobs Act, § 11051, repealed both Code § 215, which authorized an above-the-line deduction for alimony payments, and Code § 71, which included alimony payments in the recipient's gross income. For those subject to the new rules, the payor of alimony will not be able to deduct the payments, and the recipient will not include the alimony payments in gross income. This change applies to any divorce or separation instrument (as defined in former Code § 71(b)(2)) executed after 2018. It also applies to any divorce or separation instrument executed before 2018 that is modified after 2018 if the modification expressly provides that the amendments made by the Tax Cuts and Jobs Act will apply. The legislation also made various conforming amendments to other Code provisions.

F. Education

1. **Private elementary and secondary schools have a new incentive to raise tuition: up to $10,000 per year can be withdrawn tax-free from § 529 accounts to pay it.** The 2017 Tax Cuts and Jobs Act, § 11032, amended Code § 529(c) by adding § 529(c)(7), which permits tax-free distributions from § 529 accounts to pay "expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school." The limit on distributions for this purpose is $10,000 during the taxable year, which applies per student, not per account. Thus, if a student is a designated beneficiary of more than one § 529 account, the student can receive only $10,000 free of tax for this purpose in a given year regardless of whether the funds are distributed from multiple accounts. This provision applies to distributions occurring after 2017.

G. Alternative Minimum Tax

1. **The AMT will apply to fewer individuals because of increased exemption amounts and phase-out thresholds.** The 2017 Tax Cuts and Jobs Act, § 12002, amended Code § 55(d) by adding § 55(d)(4), which increases the AMT exemption amount for non-corporate taxpayers as well as the thresholds for alternative minimum taxable income above which the exemption amount phases out. These changes apply to taxable years beginning after 2017 and before 2026; the figures will be adjusted for inflation for taxable years beginning after 2018. The legislation did not change the exemption amount or the phase-out threshold for trusts and estates. The figures for 2018 both before and after the changes made by the 2017 Tax Cuts and Jobs Act are shown in the following tables:

AMT Exemption Amounts for 2018		
Filing Status	**Before TCJA**	**After TCJA**
Married Filing Separately	$43,100	$54,700
Single and HOH	$55,400	$70,300
Married Filing Jointly and Surviving Spouses	$86,200	$109,400
Estates and Trusts	$24,600	$24,600

AMTI Phase-Out Thresholds for 2018		
Filing Status	**Before TCJA**	**After TCJA**
Married Filing Separately	$82,050	$500,000
Single and HOH	$123,100	$500,000
Married Filing Jointly and Surviving Spouses	$164,100	$1 million
Estates and Trusts	$82,050	$82,050

VI. CORPORATIONS

A. Entity and Formation

B. Distributions and Redemptions

C. Liquidations

D. S Corporations

1. If you're a cash-method S corp pining to be a C corp, here's your chance! The 2017 Tax Cuts and Jobs Act, § 13543, added new § 481(d) and new § 1371(f) to make it easier for cash-method S corporations to convert to C corporations (which typically, but not always, especially after TCJA's revisions to § 448, are accrual-method taxpayers). Specifically, new § 481(d) provides that any adjustment (such as changing from the cash to the accrual method) otherwise required under § 481(a)(2) with respect to an S to C conversion may be taken into account ratably over six years starting with the year of the change (instead of taking into account the adjustment entirely in the year of change) if three conditions are met: (i) the converting S corporation existed prior to December 22, 2017 (the date of TCJA's enactment); (ii) the conversion from S to C status takes place prior to December 22, 2019 (two years from the date of TCJA's enactment); and (iii) all of the shareholders of the S corporation on December 22, 2017, are "in identical proportions" the shareholders of the C corporation. New § 1371(f) further provides that "money" distributed by the above-described converted S corporations *after* the "post-termination transition period" (generally one year) is allocable to and chargeable against the former S corporation's accumulated adjustments account ("AAA") in the same ratio as AAA bears to accumulated earnings and profits ("E&P"). Thus, new § 1371(f) is more favorable to S corporations converting to C status than the normal rule of § 1371(e), which allows distributions of money *during* the "post-termination transition period," but not after, to be allocable to and chargeable against AAA. As a practical matter, then, S corporations converting to C corporations within the confines of new § 481(d) and § 1371(f) may make nontaxable, stock-basis reducing distributions of money out of their AAA during the one-year period following the conversion (pursuant to § 1371(e)) as well as wholly or partially (depending upon AAA as compared to E&P) nontaxable, basis-reducing distributions of money after the normal one-year, post-termination transition period. These changes to § 481 and § 1371 are permanent, but of course, will apply only to S to C conversions that meet the criteria of § 481(d) (i.e., pre-TCJA existing S corporations that convert to C status before December 22, 2019, and that have the same shareholders in the same proportions post-conversion).

2. In line with the continuing expansion of eligible shareholders of subchapter S corporations, ESBTs now may have non-U.S. individuals as current beneficiaries. The 2017 Tax Cuts and Jobs Act, § 13541, makes a technical change to § 1361(c)(2)(B)(v) such that for 2018 and future years an “electing small business trust” (an “ESBT,” as particularly defined in § 1361(e)) may have as a current beneficiary of the ESBT a “nonresident alien” individual. Under § 7701(b)(1)(B), a nonresident alien individual is someone who is neither a citizen nor a resident of the U.S. This change to § 1361 is permanent.

3. Perhaps there’s something special about ESBTs that Congress or the IRS hasn’t told us? The 2017 Tax Cuts and Jobs Act, § 13542, makes another technical change relating to ESBTs by adding new § 641(c)(2)(E) effective for taxable years beginning after 2017. New § 641(c)(2)(E) will allow the charitable contribution limitation and carryover rules of § 170 that apply to individuals to apply to ESBTs (rather than the rules applicable to trusts) when the subchapter S corporation in which the ESBT owns stock makes a charitable contribution deductible under § 170. Essentially, without getting into the details, the charitable contribution limitation and carryover rules of § 170 are more liberal for individuals than for trusts. This change to § 641 is permanent.

Planning note: Speaking of ESBTs, trusts generally are eligible for § 199A’s new 20-percent deduction for “qualified business income.” Thus, even absent estate and gift tax savings, some tax planners are advising principal shareholders of S corporations that they should consider setting up ESBTs for their children and grandchildren to own stock in their S corporations earning “qualified business income.” In particular, if the ESBT’s taxable income (before taking into account § 199A) is at or below $157,500, then “qualified business income” allocable to the ESBT shareholder would appear to be taxed at a maximum rate of 29.6% (i.e., top rate of 37% applied to taxable income reduced by the 20 deduction) regardless of § 199A’s specified service business limitation or W-2 wage and capital cap.

E. Mergers, Acquisitions and Reorganizations

F. Corporate Divisions

G. Affiliated Corporations and Consolidated Returns

H. Miscellaneous Corporate Issues

1. Back to the future: Remember the good ole days before 1986 when C corporations were tax shelters? By introducing a flat corporate tax rate of 21 percent, Congress has given new life to C corporations and will force us to relearn personal holding company, accumulated earnings tax, and other anti-abuse rules (e.g., § 269A) we’ve long ignored. The centerpiece of the 2017 Tax Cuts and Jobs Act is a permanent reduction in corporate tax rates. Section 13001 of the legislation amended § 11(b) to impose tax on taxable income of corporations, including personal service corporations, at a flat rate of 21 percent. Prior to this amendment, § 11(b) provided graduated rates with a top rate of 35 percent (which top rate applied to the first dollar of personal service corporation income). For personal service corporations and companies with significant profit from U.S. operations, the reduction in the corporate rate is a huge benefit. In fact, this rate reduction is estimated to reduce corporate income taxes by roughly $1.3 trillion over the next ten years. Prior to this change, most businesses avoided C corporation status unless they were (or planned to be) publicly traded, were so-called “blocker” corporations, or, in some cases, were taken private by investment funds. Venture capital backed companies also tended to choose C corporation status to simplify their capital structure and tax compliance obligations. Now, however, C corporation status may be a sensible choice for some personal service and other closely-held corporations, especially if the business will be held for the life of the major shareholders (thereby benefiting from the step-up in basis at death) or the shareholders will exit via a stock sale at some indeterminate time in the future. One of the authors has heard anecdotally that many older, highly compensated law firm partners (drawing $1 million or more annually and thus excluded from new § 199A) who expect to retire soon are considering incorporating as old-fashioned personal service corporations, especially those in states with high income tax rates. No doubt, the accumulated earnings tax (§§ 535-537) and the IRS’s power to reallocate income between a shareholder and his or her personal service corporation (§ 269) will come into play to deter such strategies, but a 21 percent rate as compared to a 37 percent rate is tempting. Nevertheless, despite the reduced rate, subchapter C is still a double-tax regime. In particular, asset sales (or deemed asset sales at liquidation) by C corporations will continue to suffer a big tax bite notwithstanding the reduced corporate rate. Furthermore, new § 199A must be considered for any flow-through entities. *Bottom line:* Although the authors believe that flow-through status remains the best option in most situations, the choice-of-entity analysis just got more complicated and will require even more crystal-ball gazing.

2. **Although we will have to relearn some old C corporation anti-abuse provisions, here's something we can forget: the corporate AMT.** The 2017 Tax Cuts and Jobs Act, § 12001, repealed the corporate alternative minimum tax (by amending Code § 55) effective for taxable years beginning after 2017. Corporations that incurred AMT in past years will want to be sure to claim that amount as a credit against regular tax going forward. A special rule regarding the refundable portion of the AMT credit is designed to allow a corporation to use fully in 2018 through 2021 any AMT credits carried forward. Also, corporations that have had other credits (e.g, the R&D credit) limited in past years by the AMT may be able to claim those credits going forward.

3. **A reduced corporate dividends received deduction.** The 2017 Tax Cuts and Jobs Act, § 13002, amended Code § 243 and certain other provisions to reduce the corporate dividends received deduction. Prior to this amendment, a corporation could deduct 100 percent of dividends received from a corporation in its affiliated group, 80 percent of dividends received from a corporation of which the recipient owns 20 percent or more of the stock (measured by vote and value), and 70 percent of dividends received from all other corporations. The legislation reduced the 80 percent and 70 percent figures to 65 percent and 50 percent, respectively. The legislation did not change the 100 percent dividends received deduction. These changes apply to taxable years beginning after 2017.

VII. PARTNERSHIPS

A. Formation and Taxable Years

B. Allocations of Distributive Share, Debt, and Outside Basis

1. **♫♪You got to know when to hold'em, know when to fold'em, know when to walk away, and know when to run….♫♪ Carried interests still qualify for preferential long-term capital gain rates, but the holding period just increased to 3 years for specified interests in hedge funds and other investment partnerships.** For years there has been a big brouhaha over managers of real estate, hedge fund, and other investment partnerships being taxed at preferential long-term capital gain rates (e.g., 20%) on their distributive shares of partnership income notwithstanding the fact that they received their interests in these partnerships as part of their compensation for services rendered (which compensation otherwise would be taxed at ordinary income rates). Congress and eventually President Trump have threatened for several years to take action against this "loophole." Well, at long last, Congress still has done NOTHING about it, but can claim that it did!

New § 1061. Specifically, the 2017 Tax Cuts and Jobs Act, § 13309, created new § 1061 and redesignated pre-TCJA § 1061 as § 1062. New § 1061 requires a three-year holding period for allocations of income with respect to "applicable partnership interests" to qualify for preferential long-term capital gain rates. Specifically, net long-term capital gain allocated to a partner who holds an applicable partnership interest is characterized as short-term capital gain to the extent the gain is attributable to the disposition of partnership property held by the partnership for three years or fewer. An applicable partnership interest is one that is transferred to (or is held by) a taxpayer in connection with the performance of substantial services by the taxpayer, or any other related person, in any "applicable trade or business." An applicable trade or business means any activity conducted on a regular, continuous, and substantial basis which, regardless of whether the activity is conducted in one or more entities, consists, in whole or in part, of ''raising or returning capital," and either "investing in (or disposing of) specified assets (or identifying specified assets for such investing or disposition)," or ''developing specified assets." Specified assets for this purpose generally are defined as securities, commodities, real estate held for rental or investment, cash or cash equivalents, options or derivative contracts with respect to any of the foregoing, and (*big furrowed brow here*) "an interest in a partnership to the extent of the partnership's proportionate interest in any of the foregoing" (e.g., tiered partnerships). There are significant exceptions, though, for (i) employees of another entity holding interests in a partnership that only performs services for that other entity; and (ii) partnership interests acquired for invested capital (including via a § 83(b) for a capital interest in a partnership).

What about § 1231 assets? It is unclear (at least to the authors) whether § 1061's three-year holding period rule applies to trump (*no pun intended*) quasi-capital gain treatment under § 1231. Basically, new § 1061 works by transmuting (i) otherwise net long-term capital gain (as defined in § 1222) attributable to an "applicable partnership interest" (i.e., all of a taxpayer's net long-term capital gain as normally calculated) into short-term capital gain, but (ii) only to the extent such gain exceeds net long-term capital gain (as defined in § 1222) attributable to the disposition of partnership property held by the partnership for three years or more (i.e., net long-term gain that is excluded from transmutation under § 1061). Short- and long-term capital gain (or loss) is defined under § 1222 by reference to a "capital asset" as defined in § 1221 and is determined at the partnership level. Code § 1221 excludes § 1231 assets from the definition of "capital assets." To wit, in the recent case of *CRI-Leslie, LLC v. Commissioner*, 147 T.C. No. 8 (9/7/16), the IRS was successful in arguing, over the strenuous objection of the taxpayer, that a § 1231 asset is not a "capital asset" within the meaning of § 1234A (which treats gains and losses realized upon termination of rights with respect to a "capital asset" as capital gain or loss). The taxpayer in *CRI-Leslie* had entered into a contract to sell a hotel that it owned and had received a deposit of $9.7 million. Ultimately, the buyer under the contract defaulted and forfeited the $9.7 million deposit, which was retained by the taxpayer. The hotel property was a § 1231 asset, not a capital asset. Relying upon § 1234A, the taxpayer reported the $9.7 million as net long-term capital gain. The IRS, however, asserted a deficiency based upon treating the forfeited $9.7 million deposit as ordinary income. The taxpayer argued that its characterization of the forfeited deposit as long-term capital gain was supported by the legislative history of § 1234A because, according to the taxpayer, Congress enacted § 1234A to "ensure that taxpayers received the same tax characterization of gain or loss whether the property is sold or the contract to which the property is subject is terminated." Nonetheless, the Tax Court (Judge Laro) rejected the taxpayer's argument that the legislative history of § 1234A supported the taxpayer's position. Instead, Judge Laro agreed with the IRS that "[s]ince section 1234A expressly refers to property that is 'a capital asset in the hands of the taxpayer' and no other type of property, and since property described in section 1231 is excluded explicitly from the definition of 'capital asset' in section 1221, we must conclude that the plain meaning of 'capital asset' as used in section 1234A does not extend to section 1231 property." The court was "unable find anything in the legislative history of section 1234A to support [the taxpayer's] assertion that Congress intended to include section 1231 property within its ambit." The legislative history accompanying new § 1061 likewise is bereft of any reference to § 1231 property.

What about partnership interests held by S corporations? Under § 1061(c)(4)(A), an interest in a partnership is not subject to the carried interest rule if it is held "directly or indirectly … by a corporation." Absent any limitation in the statute, the term "corporation" should include a subchapter S corporation. Has Congress left a glaring loophole?

Who cares? Isn't § 1061 just a paper tiger? New § 1061 is deserving of much more study, but we suspect that the provision will catch only those very rare taxpayers who either (i) fail to hold their carried interests for more than three years, or (ii) lack the sophisticated advice to plan around the statute. One commentator characterizes the new statute as "joke" given that most managers of real estate, hedge funds, and investment partnerships hold their carried interests for well over three years. *See* Sloan, *Carried Interest Reform is a Sham*, Washington Post, December 1, 2017. On the other hand, maybe this comment is just "fake news." New § 1061 is permanent and applies to taxable years beginning after 2017.

2. **Congress has made a technical correction to § 704(d) that makes partnership outside basis calculations with respect to charitable contributions and foreign taxes the same as for S corporations.** If you wish to avoid brain damage, stop reading and trust us that the foregoing statement is accurate. Otherwise, continue reading.

A recap of some basic rules for determining the basis of a partner's partnership interest. In general, the basis that a partner has in a partnership interest is adjusted upward by the partner's capital contributions and distributive share of income (including tax-exempt income) and downward (but not below zero) by distributions received by the partner and the partner's distributive share of losses and nondeductible expenditures. *See* § 705(a). Under § 704(d), a partner can take into account the partner's distributive share of losses for any taxable year only to the extent of the basis of the partner's partnership interest, determined after adjusting the basis for distributions and nondeductible expenditures of the partnership. *See* Reg. § 1.704-1(d)(2). To the extent such losses are limited in this manner, the excess is carried over to subsequent years and may be used when the partner has sufficient outside basis. *See* § 704(d); Reg. § 1.704-1(d)(1). But, in the case of charitable contributions and foreign taxes paid or incurred by a partnership, these items are not taken into account in computing partnership taxable income and, consequently, a partner's distributive share of income or loss of the partnership. *See* § 703(a)(2)(B) and (C). Instead, a partner separately takes into account his/her/its distributive share of these items under § 702(a)(4) and (6); however, due to a technical glitch in the regulations (*see* Reg. § 1.704-1(d)(2)), the outside basis limitation of § 704(d) did not apply properly to take into account a partner's separately-determined share of partnership charitable contributions. Specifically, if a partner had a positive outside basis, then (prior to the TCJA) the partner claimed the charitable contribution on the partner's return and reduced outside basis by the partner's separately-determined share of the adjusted basis of contributed property. If a partner had a zero outside basis, though, such partner still could claim the charitable contribution on the partner's return, but was not required to reduce outside basis. Further, those same technically-deficient regulations did not address the application of § 704(d) with respect to foreign taxes paid or accrued by a partnership, but even if they did apply to tie a partner's foreign tax deduction to the partner's basis in the partnership interest, § 901 allows a partner to take a credit in lieu of a deduction for foreign taxes paid or accrued by the partnership. Hence, in certain circumstances a partner with a zero outside basis could benefit from the partner's separately-stated share of charitable contributions or foreign taxes paid or incurred by the partnership, while another partner with a positive outside basis had to reduce outside basis for such items.

TCJA's technical correction to § 704(d). The 2017 Tax Cuts and Jobs Act, § 13503, amended § 704(d) permanently by adding new § 704(d)(3)(A) so that for taxable years beginning after 2017, a partner's outside basis is reduced by the partner's separately-stated share of charitable contributions and foreign taxes paid or incurred by the partnership before determining the partner's allowable share of distributive losses under § 704(d). In the case of a partnership's charitable contribution of appreciated property, the reduction in a partner's outside basis is determined by reference to the partner's share of the partnership's adjusted basis in the contributed property. In addition, TCJA § 13503 adds new § 704(d)(3)(B) so that, in the case of a partnership's charitable contribution of property with a fair market value in excess of its adjusted basis, the reduction in outside basis otherwise required by § 704(d)(3)(A) does not apply to the extent of the partner's separately-determined share of such excess. These changes to § 704(d) make the determination of a partner's outside basis with respect to charitable contributions and foreign taxes paid the same as the determination of subchapter S shareholder's outside basis with respect to such items. *See* § 1366(d)(4); Reg. § 1367-1(f).

C. <u>Distributions and Transactions Between the Partnership and Partners</u>

D. <u>Sales of Partnership Interests, Liquidations and Mergers</u>

1. No more technical terminations of partnerships. How will we get out of § 754 elections? The 2017 Tax Cuts and Jobs Act, § 13504, amended Code § 708(b) to repeal the § 708(b)(1)(B) rule regarding technical terminations of partnerships. Prior to amendment, § 708(b)(1)(B) treated a partnership as terminated if, within any 12-month period, there was a sale or exchange of 50 percent or more of the total interest in partnership capital and profits. This change applies to taxable years beginning after 2017. One effect of a technical termination of a partnership was that it terminated elections that had been made by the partnership. An example of this is the election under § 754 to adjust the basis of partnership assets upon certain distributions of property or upon the transfer of a partnership interest. The § 754 election formerly ended when a technical termination of a partnership occurred. Because technical terminations no longer occur, a § 754 election now can be revoked during the life of a partnership only with the consent of the IRS.

2. The Tax Court gives the IRS a lesson on the intersection of partnership and international taxation: subject to the exception in § 897(g), a foreign partner's gain from the redemption of its interest in a U.S. partnership was not income effectively connected with the conduct of a U.S. trade or business. Grecian Magnesite Mining, Industrial & Shipping Co., S.A. v. Commissioner, 149 T.C. No. 3 (7/13/17). The taxpayer, a corporation organized under the laws of Greece, held a 15 percent interest (later reduced to 12.6 percent) in Premier Chemicals, LLC, an LLC organized under Delaware law and classified for federal tax purposes as a partnership. The taxpayer accepted Premier's offer to redeem its partnership interest and received a total of $10.6 million, half of which was paid in 2008 and half in January 2009. The taxpayer and Premier agreed that the payment in January 2009 was deemed to have been paid on December 31, 2008, and that the taxpayer would not share in any profits or losses in 2009. The taxpayer realized $1 million of gain from the 2008 redemption payment and $5.2 million from the 2009 redemption payment. The taxpayer filed a return on Form 1120-F for 2008 on which it reported its distributive share of partnership items, but did not report any of the $1 million realized gain from the 2008 redemption payment. The taxpayer did not file a U.S. tax return for 2009 and thus did not report any of the $5.2 million realized gain from the 2009 redemption payment. The IRS issued a notice of deficiency in which it asserted that all of the $6.2 million of realized gain was subject to U.S. tax because it was U.S.-source income effectively connected with the conduct of a U.S. trade or business. The taxpayer conceded that $2.2 million of the gain was subject to U.S. taxation pursuant to § 897(g), which treats amounts received by a foreign person from the sale or exchange of a partnership interest as amounts received from the sale or exchange of U.S. real property to the extent the amounts received are attributable to U.S. real property interests. The taxpayer's concession left $4 million of realized gain in dispute. The Tax Court (Judge Gustafson) held that the $4 million of disputed gain was not income effectively connected with the conduct of a U.S. trade or business and therefore was not subject to U.S. taxation. (The court found it unnecessary to interpret the tax treaty in effect between the U.S. and Greece because U.S. domestic law did not impose tax on the gain and the IRS did not contend that the treaty imposed tax beyond U.S. domestic law.) In reaching this conclusion, the court addressed several issues.

The court first analyzed the nature of the gain realized by the taxpayer. Under § 736(b)(1), payments made in liquidation of the interest of a retiring partner that are made in exchange for the partner's interest in partnership property are treated as a distribution to the partner. Treatment as a distribution triggers § 731(a)(1), which provides that a partner recognizes gain from a distribution to the extent the amount of money received exceeds the partner's basis in the partnership interest and directs that the gain recognized "shall be considered as gain or loss from the sale or exchange of the partnership interest of the distributee partner." Pursuant to § 741, gain recognized from the sale or exchange of a partnership interest is "considered as gain or loss from the sale or exchange of a capital asset" except to the extent provided by § 751. (The IRS did not contend that § 751 applied.) The taxpayer asserted that these provisions lead to the conclusion that the taxpayer's gain must be treated as arising from the sale of a single asset, its partnership interest, which is a capital asset. The government argued that the taxpayer's gain must be treated as arising from the sale of separate interests in each asset owned by the partnership. Otherwise, the government argued, the rule in § 897(g), which imposes U.S. tax to the extent amounts received from the sale of a partnership interest are attributable to U.S. real property interests, would be rendered inoperable. The court agreed with the taxpayer. Section 897(g), the court explained,

> actually reinforces our conclusion that the entity theory is the general rule for the sale or exchange of an interest in a partnership. Without such a general rule, there would be no need to carve out an exception to prevent U.S. real property interests from being swept into the indivisible capital asset treatment that section 741 otherwise prescribes.

The court noted that this conclusion is consistent with the court's prior decision in *Pollack v. Commissioner*, 69 T.C. 142 (1977).

The court next addressed whether the $4 million of disputed gain was effectively connected with the taxpayer's conduct of a U.S. trade or business. Pursuant to § 875(1), the taxpayer was considered to be engaged in a U.S. trade or business because the partnership of which it was a partner, Premier, was engaged in a U.S. trade or business. Accordingly, the issue was narrowed to whether the disputed gain was effectively connected with that trade or business. Because foreign-source income is considered effectively connected with a U.S. trade or business only in narrow circumstances, which the IRS acknowledged were not present, the taxpayer's disputed gain could be considered effectively connected income only if it was U.S.-source income. Pursuant to the general rule of § 865(a), income from the sale of personal property by a nonresident is foreign-source income. The IRS asserted that an exception in § 865(e)(2) applied. Under this exception, if a nonresident maintains an office or other fixed place of business in the United States, income from a sale of personal property is U.S.-source if the sale is attributable to that office or fixed place of business. The court assumed without deciding that Premier's U.S. office would be attributed to the taxpayer under § 864(c)(5). Accordingly, the issue was whether the gain was attributable to Premier's U.S. office. Under § 864(c)(5)(B), income is attributable to a U.S. office only if the U.S. office is a material factor in the production of the income and the U.S. office "regularly carries on activities of the type from which such income, gain, or loss is derived." The court concluded that neither of these requirements was satisfied. The court examined Reg. § 1.864-6(b)(2)(i) and concluded that, although Premier's business activities might have had the effect of increasing the value of the taxpayer's partnership interest, those business activities did not make Premier's U.S. office a material factor in the production of the taxpayer's gain. Further, the court concluded, even if the U.S. office was a material factor, Premier did not regularly carry on activities of the type from which the gain was derived because "Premier was not engaged in the business of buying or selling interests in itself and did not do so in the ordinary course of business." Because the disputed gain was not U.S.-source income, it was not effectively connected with the conduct of a U.S. trade or business and therefore not subject to U.S. taxation.

- In reaching its conclusion that the taxpayer's gain was not effectively connected with the conduct of a U.S. trade or business, the court rejected the IRS's contrary conclusion in Rev. Rul. 91-32, 1991-1 C.B. 107. In that ruling, according to the court, the IRS concluded

> that gain realized by a foreign partner from the disposition of an interest in a U.S. partnership should be analyzed asset by asset, and that, to the extent the assets of the partnership would give rise to effectively connected income if sold by the entity, the departing partner's pro rata share of such gain should be treated as effectively connected income.

The court characterized the analysis in the ruling as "cursory" and declined to follow it.

- The taxpayer should have reported some of its gain in 2008, should have filed a 2009 U.S. tax return reporting gain in 2009, and should have paid tax with respect to both years because all of the gain realized from the 2008 distribution and some of the gain realized from the 2009 distribution was attributable to U.S. real property interests held by the U.S. partnership, Premier. Nevertheless, the court declined to impose either the failure-to-file penalty of § 6651(a)(1) or the failure-to-pay penalty of § 6651(a)(2) because the taxpayer had relied on the advice of a CPA and therefore, in the court's view, established a reasonable cause, good faith defense.

a. Grecian Magnesite may have won the battle, but the IRS has won the war with respect to a non-U.S. partner's sale of an interest in a partnership doing business in the U.S. (thereby codifying the IRS's position in Rev. Rul. 91-32). The 2017 Tax Cuts and Jobs Act, § 13501, amended § 864(c) by adding § 864(c)(8). New § 864(c)(8) provides that, effective for dispositions after November 27, 2017, gain or loss on the sale or exchange of all (or any portion of) a partnership interest owned by a nonresident alien individual or a foreign corporation in a partnership engaged in any trade or business within the U.S. is treated as effectively connected with a U.S. trade or business (and therefore taxable by the U.S. unless provided otherwise by treaty) to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange. The amount of gain or loss treated as effectively connected under this rule is reduced by the amount of such gain or loss that is already taxable under § 897 (relating to U.S. real property interests). TCJA § 13501 makes corresponding changes to the withholding rules for effectively connected income under § 1446. These changes to § 864(c) and § 1446 statutorily reverse the Tax Court's recent decision in *Grecian Magnesite Mining, Industrial & Shipping Co., S.A. v. Commissioner*, 149 T.C. No. 3 (7/13/17) and effectively adopt the IRS's position in Rev. Rul. 91-32, 1991-1 C.B. 107.

E. Inside Basis Adjustments

1. Fun's over! Automatic § 754 elections (and corresponding downward inside basis adjustments) are now triggered more easily under § 743(d). Under pre-TCJA law, § 743(d) applied to transfers of interests in partnerships with a "substantial built-in loss." A substantial built-in loss exists for this purpose if the partnership's aggregate adjusted basis in its assets exceeds their aggregate fair market value by more than $250,000 immediately after the transfer. The 2017 Tax Cuts and Jobs Act, § 13502, amended § 743(d) to add that, notwithstanding the absence of a substantial built-in loss of more than $250,000 in the partnership's assets, a substantial built-in loss also exists if the transferee of a partnership interest would be allocated (based upon a hypothetical liquidation of the partnership's assets at fair market value) a loss of more than $250,000 immediately after the transfer. Generally, the consequence of § 743(d) is an automatic election under § 754 resulting in a downward adjustment to a partnership's basis in its built-in loss assets. Essentially, then, § 743(d) is designed to hinder sales of partnership interests when a substantial built-in loss exists by preventing the transferee from benefitting from the absence of a § 754 election upon the partnership's subsequent sale of assets. This TCJA change is permanent. The Conference Report illustrates the application of expanded § 743(d) as follows:

> For example, a partnership of three taxable partners (partners A, B, and C) has not made an election pursuant to section 754. The partnership has two assets, one of which, Asset X, has a built-in gain of $1 million, while the other asset, Asset Y, has a built-in loss of $900,000. Pursuant to the partnership agreement, any gain on sale or exchange of Asset X is specially allocated to partner A. The three partners share equally in all other partnership items, including in the built-in loss in Asset Y. In this case, each of partner B and partner C has a net built-in loss of $300,000 (one third of the loss attributable to asset Y) allocable to his partnership interest. Nevertheless, the partnership does not have an overall built-in loss, but a net built-in gain of $100,000 ($1 million minus $900,000). Partner C sells his partnership interest to another person, D, for $33,333. Under the provision, the test for a substantial built-in loss applies both at the partnership level and at the transferee partner level. If the partnership were to sell all its assets for cash at their fair market value immediately after the transfer to D, D would be allocated a loss of $300,000 (one third of the built-in loss of $900,000 in Asset Y). A substantial built-in loss exists under the partner-level test added by the provision, and the partnership adjusts the basis of its assets accordingly with respect to D.

This change applies to transfers of partnership interests after 2017.

F. Partnership Audit Rules

G. Miscellaneous

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

1. Congress shoots a probable NCAA "airball": After TCJA, it will cost 21 percent more to pay big-time, private school coaches like Coach K (Duke-$7.2M); but Wildcat fans celebrate as Coach Calipari (Kentucky-$6.5M) gets an "assist" from the IRS. Presumably believing that $1 million salaries at tax-exempt organizations are per se unreasonable, Congress decided to take a "shot" (*pun intended*) at curtailing them under TCJA. Specifically, the 2017 Tax Cuts and Jobs Act, § 13602, adds Code § 4960 to impose a 21 percent excise tax on "applicable tax-exempt organizations" ("ATEOs") and broadly-defined "related organizations" paying over $1 million annually to "covered employees." In addition to § 527 political organizations and § 521 farmers cooperatives, ATEOs include the following two additional types of organizations: (i) those exempt from tax under § 501(a) (most nonprofits, including churches, hospitals, and private schools); and (ii) those "with income excluded from taxation under § 115(l)" (income of certain public utilities and income derived from "any essential governmental function and accruing to a State or any political subdivision thereof"). A "covered employee" is defined as any one of the five highest compensated employees of an ATEO either (i) for the current taxable year or (ii) for any year beginning after December 31, 2016. Licensed medical or veterinarian professionals, however, are excluded from the definition of "covered employee." New § 4960 is permanent and effective for taxable years beginning after 2017. Given that many tax-exempt organizations have taxable years ending June 30 or October 31, many potentially affected organizations will have time to either comply or attempt to avoid new § 4960.

The probable NCAA "airball." Congress apparently thought that new § 4960 defined an ATEO so that both public and private colleges and universities would have to pay the 21 percent excise tax on compensation exceeding $1 million. The legislative history accompanying § 4960 states: "An [ATEO] is an organization exempt from tax under section 501(a), an exempt farmers' cooperative, *a Federal, State or local governmental entity with excludable income*, or a political organization." *See* H.R. Conf. Rep. No. 115-466, at 492 (Dec. 15, 2017) (emphasis added). At least one well-respected exempt organization scholar, however, has pointed out that, at least according to the IRS, "[i]ncome earned by a state, a political subdivision of a state, or an integral part of a state or political subdivision of a state" is not taxable regardless of § 115, citing Rev. Rul. 87-2, 1987-1 C.B. 18. Instead, it is the IRS's position that public colleges and universities are not taxable under our federalist system unless and until Congress enacts a specific statutory provision subjecting such state-affiliated organizations to tax like § 511(a)(2)(B) (state colleges and universities are subject to unrelated business income tax). *See* the blog post by Professor Ellen P. Aprill here, and her full law review article on the subject: Ellen P. Aprill, *The Integral, the Essential, and the Instrumental: Federal Income Tax Treatment of Government Affiliates*, 23 J. Corp. Law 803 (1997).

And another thing … Churches are exempt from taxation under § 501(a) along with hospitals and private schools. But we wouldn't bet money that any church paying its pastor more than $1 million annually is going to pay an excise tax under new §4960 without a fight based on the First Amendment. Ultimately, the church may lose such a fight because it is clear that churches are subject to the unrelated business income tax of § 511, but if a church can pay its pastor $1 million a year, it can pay a tax lawyer to litigate too.

2. Successful private colleges and universities really must be in the dog house because, in addition to taxing them for highly-paid coaches, Congress has decided to tax their endowments too! And, just to keep us on our toes, the legislative history says the statute turns on the number of an institution's "tuition paying" students, but § 4968 simply reads "students." The 2017 Tax Cuts and Jobs Act, § 13701, adds § 4968 which imposes a new 1.4 percent annual excise tax upon the net investment income of certain private colleges and universities and affiliated organizations with endowments worth $500,000 or more per full-time student. The excise tax imposed by new § 4968 is similar in many respects to the annual excise tax imposed upon private foundations under § 4940. In particular, new § 4968 applies to an "applicable educational institution" which is defined as institution: (i) that is an "eligible educational institution" as described in § 25A(f)(2) (which in turn refers to 20 U.S.C. § 1088); (ii) that has at least 500 students during the preceding taxable year more than 50 percent of which are in the U.S.; (iii) that is not described in the first section of § 511(a)(2)(B) (state colleges and universities); and (iv) that has assets (other than assets used directly in carrying out the institution's exempt purpose) with an aggregate fair market value as of end of the preceding taxable year of at least $500,000 per student. For this latter purpose, the number of students of an institution is based on the daily average number of full-time students attending the institution, with part-time students taken into account on a full-time student equivalent basis. Moreover, the legislative history of new § 4968 states that the $500,000 per student figure should be calculated based upon "tuition paying" students; however, the Senate Parliamentarian struck that language from § 4968 immediately before it was passed by the House and Senate. Whether regulations can fill in the gap is anybody's guess. New § 4968 is permanent and effective for taxable years beginning after 2017, again giving fiscal-year private colleges and universities time to cope.

3. Oh goody! Changes to the UBIT rules too! The 2017 Tax Cuts and Jobs Act, §§ 13702 and 13703, also made certain changes to the determination of unrelated business income with respect to tax-exempt organizations. Most tax-exempt organizations are subject to federal income tax at regular rates (corporate rates for exempt corporations and trust rates for exempt trusts) on net income (i.e., after permissible deductions) from a trade or business, regularly carried on, that is unrelated to the organization's exempt purpose (other than its need for revenue). Exceptions exist for most types of passive, investment income as well as for narrow categories of other types of income (e.g., thrift store sales). *See* §§ 511-514.

Stop using good UBI money to chase bad UBI money! Under pre-TCJA law, if an exempt organization had unrelated business income from one activity, but unrelated losses from another activity, then the income and losses could offset, meaning that the organization would report zero or even negative UBI. Congress apparently doesn't like this result, so under new § 512(a)(6) income and losses from separate unrelated businesses no longer may be aggregated. This new UBI provision is effective for taxable years beginning after 2017, thus giving fiscal year nonprofits some time to plan. Moreover, under a special transition rule, unrelated business income net operating losses arising in a taxable year beginning before January 1, 2018, that are carried forward to a taxable year beginning on or after such date, are not subject to § 512(a)(6).

Congress doesn't like using UBI to help fund fringe benefits, so when your organization's employees are pumping iron at the charity's free gym, you can pump up your UBI too. Under new § 512(a)(7), an organization's unrelated business taxable income is increased by the amount of any expenses paid or incurred by the organization that are not deductible because of the limitations of § 274 for (i) qualified transportation fringe benefits (as defined in § 132(f)); (ii) a parking facility used in connection with qualified parking (as defined in § 132(f)(5)(C)); or (iii) any on-premises athletic facility (as defined in § 132(j)(4)(B)). New § 512(a)(7) is effective for amounts paid or incurred after 2017, so affected tax-exempt organizations need to deal with this change immediately.

Perhaps worth noting here: Because the TCJA reduced the top federal income tax rate on C corporations to 21 percent, it likewise reduced to 21 percent the top rate on UBI of tax-exempt organizations formed as nonprofit corporations, which are the vast majority. So, the news for tax exempts is not all bad.

B. Charitable Giving

1. Provisions of the 2017 Tax Cuts and Jobs Act that affect charitable contributions.

a. If the legislation does not cause you to take the standard deduction, you can deduct even more of your cash contributions to public charities. The 2017 Tax Cuts and Jobs Act, § 11023, added new Code § 170(b)(1)(G) and redesignated existing § 170(b)(1)(G) as § 170(b)(1)(H). New § 170(b)(1)(G) increases the limit that applies to the deduction of certain charitable contributions by individuals. Prior to the Tax Cuts and Jobs Act, the limit on the deduction for charitable contributions that an individual made to a public charity or certain other organizations was 50 percent of the individual's contribution base, which, generally speaking, is adjusted gross income. The legislation increased this percentage to 60 percent for *cash contributions* that an individual makes to public charities and certain other organizations specified in § 170(b)(1)(A). Any contribution that exceeds this limit can be carried forward to each of the succeeding five years. This increased limit applies to taxable years beginning after 2017 and before 2026.

b. If you don't get a contemporaneous written acknowledgment for your charitable contribution over $250, the donee charity no longer can bail you out with an amended Form 990. Plus, Treasury and the IRS can check at least one regulatory project off the "to do" list. Under Code § 170(f)(8), a taxpayer's charitable contribution of $250 or more is disallowed unless the taxpayer obtains a "contemporaneous written acknowledgement" ("CWA") of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service) to the taxpayer in consideration for the contribution. On the other hand, § 170(f)(8)(D) provides an exception to the CWA requirement if the donee charity files a return, on such form and in accordance with such regulations as the Secretary may prescribe, that includes the same content. Yet, the IRS's position (which has been upheld 8-3-6 by the Tax Court in a reviewed opinion by Judge Lauber) has been that the § 170(f)(8)(D) exception is not available unless and until the Treasury Department and the IRS issue final regulations implementing the exception, which to date they have not done. *See, e.g.*, 15 West 17th Street LLC v. Commissioner, 147 T.C. No. 19 (12/22/16). The 2017 Tax Cuts and Jobs Act, § 13705, permanently repealed § 170(f)(8)(D) effective for taxable years beginning after December 31, 2016.

c. No more charitable contribution deduction for 50-yard line seats! Normally, a taxpayer who receives a substantial return benefit for a payment to a charity (e.g., admission to the museum) cannot claim a charitable contribution deduction for the payment. Under pre-TCJA law, though, special rules applied to certain payments to colleges and universities in exchange for rights to purchase preferred tickets or seating at athletic events. These special rules (§ 170(l)) generally permitted the taxpayer to treat 80 percent of a payment to a college or university as a charitable contribution even when preferred seating or ticket rights were granted in exchange if (i) the amount was paid to or for the benefit of a school with a regular faculty and curriculum and meeting certain other requirements; and (ii) such amount would have been allowable as a charitable contribution deduction but for the fact that the taxpayer received (directly or indirectly) as a result of the payment the right to purchase tickets for seating at the school's athletic events. The 2017 Tax Cuts and Jobs Act, § 13704, permanently amended § 170(l) so that no charitable contribution deduction is allowed with respect to payments for the right to purchase tickets or seating at a school's athletic events. The amendment to § 170(l) is effective for contributions made in taxable years beginning after 2017.

X. TAX PROCEDURE

A. Interest, Penalties and Prosecutions

1. Return preparers need to be extra careful with not only the earned income tax credit, but also with the child tax credit, additional child tax credit, and the American Opportunity Tax Credit. T.D. 9799, Tax Return Preparer Due Diligence Penalty Under Section 6695(g), 81 F.R. 87444 (12/5/16). The Treasury Department and the IRS have issued proposed and temporary regulations that amend Reg. § 1.6695-2 to implement changes made by the Protecting Americans from Tax Hikes Act of 2015. These changes extend the § 6695(g) preparer due diligence requirements to returns or claims for refund including claims of the child tax credit (CTC), additional child tax credit (ACTC), and American Opportunity Tax Credit (AOTC), in addition to the earned income credit (EIC). As a result of these changes, one return or claim for refund may contain claims for more than one credit subject to the due diligence requirements. Each failure to comply with the due diligence requirements set forth in the regulations results in a penalty, and therefore more than one penalty could apply to a single return or claim for refund. Examples in the temporary regulations illustrate how multiple penalties could apply when one return or claim for refund is filed. Revisions to Form 8867 have been made for 2016 so that it is a single checklist to be used for all applicable credits. The temporary regulations are effective on December 5, 2016.

a. Congress has directed Treasury to issue preparer due diligence requirements with respect to head-of-household filing status. The 2017 Tax Cuts and Jobs Act, § 11001(b), amended Code § 6695(g) to extend the preparer due diligence requirements to returns or claims for refund that claim eligibility for head-of-household filing status. This change is effective for taxable years beginning after 2017.

2. Congress has reduced to zero the Affordable Care Act's penalty for failure to maintain minimum essential coverage for months beginning after 2018. The 2017 Tax Cuts and Jobs Act, § 11081, amended Code § 5000A(c) to reduce to zero the penalty enacted as part of the Affordable Care Act for failing to maintain minimum essential coverage. This change applies to months beginning after 2018. Accordingly, for 2017 and 2018, individual taxpayers still must answer the question on the return concerning whether they and other household members had minimum essential coverage and will be subject to the penalty of § 5000A(c) (referred to as the shared responsibility payment) for failure to maintain such coverage. Under § 5000A(c)(1) and Reg. § 1.5000A-4(a), the individual shared responsibility payment for months during which an individual fails to maintain minimum essential coverage is the lesser of: (1) the sum of the monthly penalty amounts (generally 1/12 of the greater of a fixed dollar amount—$695 per adult with a family maximum of $2,085 for 2017—or a percentage—2.5 percent for 2017—of the amount by which household income exceeds the filing threshold), or (2) the sum of the monthly national average bronze plan premiums for the shared responsibility family—$272 per month per individual for 2017.

B. <u>Discovery: Summons and FOIA</u>

C. <u>Litigation Costs</u>

D. <u>StatutoryNotice of Deficiency</u>

E. <u>Statute of Limitations</u>

1. The time period for the IRS to return wrongfully levied funds, and for taxpayers to bringing suit for wrongful levy, is now two years. The 2017 Tax Cuts and Jobs Act, § 11071, amended Code § 6343(b) to increase from nine months to two years the period of time within which the IRS can return to a taxpayer money (or monetary proceeds from the sale of property) upon which the IRS has wrongfully levied. The legislation also amended Code § 6532(c) to increase from nine months to two years the period of time within which a taxpayer can bring an action for wrongful levy. Under both Code provisions, the two-year period runs from the date of levy. These amendments are effective with respect to (1) levies made after the date of enactment, which is December 22, 2017, and (2) levies made on or before December 22, 2017 provided that the nine-month period had not expired as of the date of enactment.

F. <u>Liens and Collections</u>

G. <u>Innocent Spouse</u>

H. <u>Miscellaneous</u>

XI. <u>WITHHOLDING AND EXCISE TAXES</u>

XII. <u>TAX LEGISLATION</u>

A. <u>Enacted</u>

1. Congress couldn't even get the name right in this legislation. Nevertheless, this is significant legislation that affects virtually all areas of federal taxation. An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, was signed by the President on December 22, 2017. This legislation is colloquially referred to as the Tax Cuts and Jobs Act ("TCJA"). (The legislation included the short title "Tax Cuts and Jobs Act," but the name was stricken by the Senate Parliamentarian immediately prior to the Senate's passage of the final bill.) The TCJA makes significant amendments to the Internal Revenue Code of 1986 that are too numerous to list. The Conference Report accompanying the TCJA may be found here. The legislation generally applies to tax years beginning after 2017. Many of the TCJA changes affecting individual taxpayers are temporary and sunset for taxable years beginning after 2025. Some provisions, such as certain amendments of the rules for depreciation, apply prior to 2018.

XIII. <u>TRUSTS, ESTATES & GIFTS</u>

A. <u>Gross Estate</u>

B. <u>Deductions</u>

1. "The difference between death and taxes is death doesn't get worse every time Congress meets." Well, estate and gift taxes actually just got a little better. Congress has doubled the basic exclusion amount. The 2017 Tax Cuts and Jobs Act, § 11061, amended Code § 2010(c)(3) by adding § 2010(c)(3)(C), which increases the basic exclusion amount from $5 million to $10 million for decedents dying after 2017 and before 2026. Pursuant to § 2010(c)(3)(B), the $10 million amount is adjusted for inflation for calendar years after 2011. Accordingly, for 2018, the basic exclusion amount is $11.2 million. The legislation also directs the Treasury Department to issue regulations to carry out the new rule with respect to any difference between the exclusion amount in effect at the time of the decedent's death and the amount in effect at the time of any gifts the decedent made.

C. Gifts

D. Trusts