On December 22, President Trump signed into law H.R. 1 (Pub. L. No. 115-97), the first major overhaul of the U.S. tax system in 30 years. The Act's primary changes are to lower the corporate tax rate to 21%, lower and broaden the individual tax rates and brackets, provide a deduction for pass-through businesses, and create a territorial tax system for multinational businesses.

INDIVIDUAL TAX REFORM

Rates, Standard Deduction, and Exemptions

Individual income tax rates [Act §11001, §11002; I.R.C. §1, §6695] —

Current Law

For tax year 2017, there are seven regular individual income tax brackets of 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%, and five categories of filing status. The income levels for each bracket threshold are indexed annually based on increases in the Consumer Price Index (CPI).

Act

The Act changes the tax rates and tax bracket structure by providing seven tax brackets: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The new structure is in place for tax years beginning after December 31, 2017, and before January 1, 2026.

For married taxpayers filing jointly, the 12% bracket threshold is $19,050, the 22% bracket threshold is $77,400, the 24% bracket threshold is $165,000, the 32% bracket threshold is $315,000, the 35% bracket threshold is $400,000, and the 37% bracket threshold is $600,000.

For married individuals filing separately, the 12% bracket threshold is $9,525, the 22% bracket threshold is $38,700, the 24% bracket threshold is $82,500, the 32% bracket threshold is $157,500, the 35% bracket threshold is $200,000, and the 37% bracket threshold is $300,000.

For single filers, the 12% bracket threshold is $9,525, the 22% bracket threshold is $38,700, the 24% bracket threshold is $82,500, the 32% bracket threshold is $157,500, the 35% bracket threshold is $200,000, and the 37% bracket threshold is $300,000.

For taxpayers filing as head of household, the 12% bracket threshold is $13,600, the 22% bracket threshold is be $51,800, the 24% bracket threshold is be $82,500, the 32% bracket threshold is $157,500, the 35% bracket threshold is $200,000, and the 37% bracket threshold is $500,000. For trusts and estates, the first $2,550 of taxable income is subject to a tax of 10%, the 24%

bracket threshold is $2,550, the 35% bracket threshold is $9,150, and the 37% bracket threshold is $12,500.

The Act revises the 0% capital gains rate brackets by changing the 25% rate to a 15% rate threshold and changing the 39.6% rate threshold to a 20% rate threshold. For married taxpayers filing jointly (and surviving spouses), the 15% rate threshold is $77,200, and the 20% rate threshold is $479,000.

For married taxpayers filing separately, the 15% rate threshold is $38,600, the 20% rate threshold is be $239,500. For taxpayers filing with head of household status, the 15% rate threshold is $51,700, and the 20% rate threshold is $452,400. For other individuals, the 15% rate threshold is $51,700, and the 20% rate threshold is $425,800.

All income thresholds are indexed for Chained Consumer Price Index for All Urban Consumers (C-CPI-U) instead of CPI starting after 2018. Use of the Chained CPI slows the growth of the tax brackets causing rising incomes to be subject to higher tax rates.

The Act applies ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child. Any earned income of a child is taxed according to an unmarried taxpayer's brackets and rates. The Act does not require that the child's tax be affected by the tax situation of the child's parents or unearned income of any siblings. This change does not apply to tax years beginning after December 31, 2025.

Additionally, the Act directs the Secretary of Treasury to promulgate due diligence requirements for paid preparers in determining eligibility for a taxpayer to file as head of household. If a paid preparer fails to follow the due diligence requirements promulgated by the Secretary, the paid preparer is subject to a $500 penalty.

Standard deduction [Act §11021; I.R.C. §63] —

Current Law

An individual reduces adjusted gross income (AGI) by personal exemption deductions and either (i) the applicable standard deduction or (ii) itemized deductions, to determine taxable income. The basic standard deduction varies depending upon a taxpayer's filing status. For 2017, the standard deduction is $6,350 for single individuals and married individuals filing separate returns, $9,350 for heads of households, and $12,700 for married individuals filing a joint return. The amounts of the basic and additional standard deductions are indexed annually for inflation (CPI). Taxpayers may elect to claim itemized deductions in lieu of taking the applicable standard deductions. Taxpayers blind or 65 or older are eligible for an increased standard deduction.

Act

The Act increases the standard deduction to $24,000 for married individuals filing a joint return, $18,000 for taxpayers filing as head of household, and $12,000 for all other taxpayers for taxable years beginning after December 31, 2017, and before January 1, 2026. In addition to enhancing the standard deduction, the Act preserves the additional standard deduction for the elderly and the blind.

The Act provides that these amounts be indexed for inflation using C-CPI-U for tax years beginning after December 31, 2018.

Effective for taxable years beginning after December 31, 2017.

Personal exemptions [Act §11041; I.R.C. §151, §152, §153, §3402] —

Current Law

A taxpayer generally may claim personal exemptions for the taxpayer, the taxpayer's spouse, and any dependents. For 2017, taxpayers may deduct $4,050 for each personal exemption. The exemption amount is indexed annually for inflation (CPI). Additionally, a personal exemption phase-out (PEP) reduces a taxpayer's personal exemptions by 2% for each $2,500 ($1,250 for married filing separately) by which the taxpayer's AGI exceeds $261,500 (single), $287,650 (head-of-household), $313,800 (married filing jointly), and $150,000 (married filing separately). These threshold amounts apply to tax year 2017 (and also are indexed for inflation).

Act

The Act suspends the deduction for personal exemptions for taxable years beginning after December 31, 2017, and before January 1, 2026, by making the exemption amount $0.

The Act requires only single individuals to file a tax return if their gross income for the tax year exceeds the applicable standard deduction. Married taxpayers are required to file a tax return if one individual's gross income, when combined with the individual's spouse's gross income, is more than the standard deduction available for joint returns. This requirement applies only to married taxpayers if (1) the individual and his or her spouse, at the close of the tax year, had the same household as their home, (2) the individual's spouse did not file a separate tax return, and (3) neither the individual nor his spouse is a dependent of another taxpayer with income (other than earned income) in excess of $500 (indexed for inflation).

The Act requires the Treasury to develop rules to determine the amount of tax required to be withheld by employers from a taxpayer's wages, but gives the IRS discretion to leave withholding rules in place for 2018.

Effective for taxable years beginning after December 31, 2017.

Family and Individual Tax Credits

Child tax credit [Act §11022; I.R.C. §24] —

Current Law

An individual may claim a $1,000 tax credit for each qualifying child under the age of 17. The aggregate amount of child tax credits that may be claimed is phased out by $50 for each $1,000 of AGI over $75,000 for single filers and $110,000 for joint filers. Neither the $1,000 credit amount nor the AGI thresholds are indexed for inflation. The taxpayer must submit a valid taxpayer identification number (TIN) for each child for whom the credit is claimed.

To the extent the child tax credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit (ACTC)) equal to 15% of earned income in excess of $3,000. The taxpayer is not required to have a Social Security number (SSN) to claim the refundable portion of the credit.

Act

The Act makes several changes to the child tax credit for tax years beginning after December 31, 2017, and before January 1, 2026.

First, the Act increases the child tax credit to $2,000 per qualifying child. A qualifying child continues to be a child under the age of 17. Additionally, a $500 nonrefundable credit is available for qualifying dependents other than qualifying children. The Act does not change the current-law definition of dependent. However, the Act does not allow the $500 credit for certain residents of contiguous countries to the United States that are otherwise meet the standard definition of a dependent.

The earned income threshold for the refundable portion of the child tax credit is lowered from $3,000 to $2,500. The maximum amount refundable may not exceed $1,400 per qualifying child (indexed for inflation after 2018).

The Act requires taxpayers to provide the Social Security number of each qualifying child for whom the credit is claimed. The Social Security number must be issued prior to the filing of the return claiming the credit. The Social Security number requirement does not apply to the $500 non-refundable credit. Therefore, under the Act, a qualifying child who does not have a Social Security number can still qualify for the $500 credit.

Under the Act, the child tax credit begins to phase out at $400,000 for married taxpayers filing a joint return and $200,000 for all other taxpayers. These amounts are not be indexed for inflation.

Effective for tax years beginning after December 31, 2017.

Educational Incentives

Coverdell education accounts and §529 plans [Act §11032; I.R.C. §529, §530] —

Current Law

Income earned by Coverdell education savings accounts is exempt from tax. Contributions are not deductible and may not exceed $2,000 per beneficiary annually, and may not be made after the designated beneficiary reaches age 18 (except in the case of a special needs beneficiary). The contribution limit is phased out for contributors with modified adjusted gross income between $95,000 and $110,000 ($190,000 and $220,000 for married taxpayers filing a joint return). Distributions from a Coverdell account are excludible from the beneficiary's gross income if used to pay for qualified education expenses. Qualified education expenses include qualified higher education expenses and qualified elementary and secondary school expenses for attendance in kindergarten through grade 12.

Act

The Act amends the definition of qualified higher education expense to include expenses for tuition paid in connection with enrollment or attendance at an elementary school or secondary public, private, or religious school. The Act limits the amount of cash distributions to $10,000 per year for elementary and secondary school expenses.

Effective for distributions made after December 31, 2017.

Discharge of student loan indebtedness [Act §11031; I.R.C. §108] —

Current Law

Generally, debt that is forgiven constitutes gross income to the debtor, even if the debt is forgiven on account of death or disability.

However, certain student loans are excluded from income if cancellation of the student debt is contingent on the student's working for a certain period of time in certain professions. There is another exclusion for the forgiveness of student loans made by educational organizations out of private, nongovernment funds if the proceeds are used to pay costs of attendance at an education institution or to refinance any outstanding student loans, and the student is not employed by the lender organization. However, if such loans are made or refinanced by educational organizations (or refinancing loans made by certain tax-exempt organizations), the cancelled student debt is not excludible from income unless the cancellation is contingent on the student working in an

occupation or area with unmet needs and the work is required to be performed for, or under the direction of, a tax-exempt charity or a governmental entity. Finally, gross income does not include any loan repayment amount received under the National Health Service Corps loan repayment program, certain state repayment programs, or any amount received by an individual under any state loan repayment or loan forgiveness program intended to provide for the increased availability of health care services in underserved or health professional shortage areas.

Act

The Act excludes from taxable income for taxable years beginning after December 31, 2017, and before January 1, 2026, income resulting from the discharge of certain student debt on account of the death or total and permanent disability of the student.

Eligible loans include loans made by the United States, a state, certain tax-exempt public benefit corporations that control a state, county, or municipal hospital and whose employees have been deemed to be public employees under state law, an educational organization that originally received the funds from which the loan was made from the United States, a state, or a tax-exempt public benefit corporation, or private education loans.

Effective for discharges of loans after December 31, 2017.

Rollovers between qualified tuition programs and qualified ABLE programs [Act §11025; I.R.C. §529, §529A] –

Current Law

Owners of qualified tuition programs under §529 can rollover the funds to another account without subjecting the funds to income tax. Rollovers to qualified ABLE accounts under §529A are not permitted.

Qualified ABLE programs are tax-favored savings programs intended to benefit disabled individuals. They are established and maintained by state agencies (or instrumentalities thereof), and must meet certain conditions. For instance, contributions may be made to an ABLE account established for the purpose of meeting the qualified disability expenses of the designated beneficiary of the account and the program must limit a designated beneficiary to one ABLE account. Qualified ABLE programs are generally exempt from income tax, but are subject to taxes imposed on unrelated business income of a tax-exempt organization.

Act

The Act permits taxpayers, before January 1, 2026, to roll over amounts from qualified tuition programs (§529 accounts) to ABLE accounts without penalty, but only if the designated beneficiary (or member of the beneficiary's family) of the qualified tuition plan owns the ABLE account. Such amounts would count toward the overall limitation on contributions to an ABLE account within a tax year, and any excess amount would be included in the distributee's gross income as provided by §72.

Effective for distributions after December 22, 2017.

Simplification and Reform of Deductions

Overall limitation on itemized deductions [Act §11046; I.R.C. §68] —

Current Law

The total amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, and casualty, theft, or wagering losses) is limited for certain upper-income taxpayers (sometimes referred to as the "Pease" limitation). This limitation applies on top of any other limitations applicable to such deductions. Under the Pease limitation, the otherwise allowable total amount of itemized deductions is reduced by 3% of the amount by which the taxpayer's adjusted gross income exceeds a threshold amount. For 2017, the threshold amount is (1) $261,500 for single individuals, (2) $313,800 for married couples filing joint returns and surviving spouses, (3) $287,650 for heads of households, and (4) $156,900 for married individuals filing a separate return. The Pease limitation does not reduce itemized deductions by more than 80%.

Act

The Act suspends the overall limitation on itemized deductions during taxable years beginning after December 31, 2017, and before January 1, 2026.

Effective for taxable years beginning after December 31, 2017.

Mortgage and home equity interest deduction [Act §11043; I.R.C. §163] —

Current Law

Taxpayers may claim itemized deductions for mortgage interest paid with respect to a principal residence and one other residence of the taxpayer. Taxpayers who itemize their deductions may deduct interest payments on up to $1 million in acquisition indebtedness (for acquiring, constructing, or substantially improving a residence), and up to $100,000 in home equity indebtedness. Under the alternative minimum tax (AMT), however, the deduction for home equity indebtedness is disallowed.

Act

For tax years beginning after December 31, 2017, and beginning before January 1, 2026, the Act provides that, for taxpayer's that itemize deductions, to deduct qualified residence interest payments on indebtedness of up to $750,000 ($375,000 for married filing separately). Once the suspension period is over, the limitation reverts back to $1,000,000 ($500,000 for married filing separately) even if the indebtedness was incurred during the suspension period and limited by the reduced amounts. For example, if a taxpayer has a $900,000 loan taken out in 2022, the interest deduction will be limited on payments up to the $750,000 loan limit, but once the suspension period is over, the interest payments can be determined based on the original $900,000 loan..

The Act grandfathers the treatment of indebtedness incurred on or before December 15, 2017. The Act also contains a binding contract exception for written binding contracts entered into before December 15, 2017 (written binding contract to close on the purchase of a principal residence before January 1, 2018, and who purchases such residence before April 1, 2018).

The Act also provides that qualified residence interest includes interest on refinanced indebtedness, but only to the extent the amount of indebtedness resulting from the refinancing does not exceed the amount of the refinanced indebtedness.

The Act suspends the deduction for interest on home equity indebtedness for tax years beginning after December 31, 2017, and before January 1, 2026.

Effective for taxable years beginning after December 31, 2017.

State and local taxes [Act §11042; I.R.C. §164] —

Current Law

Individuals may claim itemized deductions for state and local government income and property taxes paid. In lieu of the itemized deduction for state and local income taxes, individuals may claim an itemized deduction for state and local government sales taxes.

Act

The Act generally provides that state, local, and foreign property taxes and State and local sales taxes paid by individuals are allowed as a deduction only when paid or accrued in carrying on a trade or business, or other income producing activity. The Act generally denies a deduction for individual, state and local income, war profits and excess profits taxes, with the exception that an individual taxpayer could take an itemized deduction up to $10,000 ($5,000 for a married taxpayer filing a separate return) for the aggregate of (i) state and local property taxes not paid or accrued in carrying on a trade or business, or other income producing activity, and (ii) State and local income, war profits, and excess profits taxes paid or accrued in the taxable year.

Effective for tax years beginning after December 31, 2017, and beginning before January 1, 2026. However, for an amount paid in a tax year beginning before January 1, 2018, with respect to a state or local income tax imposed for a tax year beginning after December 31, 2017, the payment shall be treated as paid on the last day of the taxable year for which such tax is so imposed for the purposes of applying the provision limiting the dollar amount of the deduction. Thus, an individual may not claim an itemized deduction in 2017 on a pre-payment of income tax for a future tax year in order to avoid the dollar limitation applicable for tax years beginning after 2017. Editor's Note: See IR-2017-210 for IRS guidance on the deductibility of property tax prepayments in 2017.

Personal casualty loss and theft loss deduction [Act §11044; I.R.C. §165] —

Current Law

Individuals may claim itemized deductions for personal casualty losses (i.e., losses not connected with a trade or business or entered into for profit), including property losses arising from fire, storm, shipwreck, or other casualty, or from theft. Certain tax legislation, including the Disaster Tax Relief and Airport and Airway Extension Act of 2017 (Pub. L. No. 115-63), provided for a special above-the-line deduction for personal casualty losses arising from specified natural disasters.

Act

The Act disallows the deduction for personal casualty and theft losses incurred in taxable years beginning after December 31, 2017, and before January 1, 2026, except for certain casualty losses incurred in a disaster declared by the President under §401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

Effective for taxable years beginning after December 31, 2017.

Editor's Note: See Act §11029, below, that alters the personal casualty loss rules related to major 2016 federally declared disasters.

Limitation on wagering losses [Act §11050; I.R.C. §165] —

Current Law

Taxpayers may claim itemized deductions for losses from gambling, but only to the extent of gambling winnings. However, taxpayers may claim other deductions connected to gambling that are deductible regardless of gambling winnings.

Act

The Act clarifies that for taxable years beginning after December 31, 2017, and before January 1, 2026, "losses from wagering transactions," as that term is used in §165(d) — which allows losses from wagering transactions to be deducted only to the extent of the gain from wagering transactions — applies to the actual cost of wages as well as expenses incurred by the individual in connection with an individual's gambling activity. For example, an individual's otherwise deductible expenses in traveling to or from a casino would be subject to the §165(d) limitation.

Effective for taxable years beginning after December 31, 2017.

Charitable contributions [Act §11023, §13704, §13705; I.R.C. §170] —

Current Law

AGI Limitation

Charitable contribution deductions to public charities and certain private foundations are limited to 50% of an individuals's AGI.

Contributions to colleges and universities for the right to purchase seating at athletic events

A taxpayer may take a charitable contribution deduction for 80% of the amount contributed to or for the benefit of an educational organization where the donor receives the right to purchase tickets for seating at an athletic event in an athletic stadium of such institution.

Charitable mileage rate for passenger automobile use

Taxpayers are entitled to a charitable deduction when using their passenger automobile in providing services to a charitable organization at a standard mileage rate of $0.14 per mile.

Exception to substantiation requirements when donee organization files return with required information

Subject to regulations to be drafted by Treasury and the IRS, taxpayers are not required to provide a contemporaneous written acknowledgment of their donations of $250 or more when a donee organization files a return with the required information.

Act

The Act increases the limitation for cash contributions by individual taxpayers to 60% of the individual's AGI for taxable years beginning after December 31, 2017, and before December 31, 2026.

Effective for contributions made in taxable years beginning after December 31, 2017.

The Act eliminate in its entirety the deduction for contributions to educational organizations when a donor receives the right to purchase tickets for seating at athletic events by providing that no deduction is available for such contributions.

Effective for contributions made in taxable years beginning after December 31, 2017.

The Act repeals the exception to the contemporaneous written acknowledgement requirement for contributions of $250 or more when the donee organization files the required return.

Effective for taxable years beginning after December 31, 2016.

Medical expense deduction [Act §11027; I.R.C. §105, §213] —

Current Law

Taxpayers may claim itemized deductions for out-of-pocket medical, dental and related expenses of the taxpayer, a spouse, or a dependent not compensated for by insurance. This deduction is allowed only to the extent the expenses exceed 10% of the taxpayer's adjusted gross income. A special rule applicable to taxpayers (or their spouses) who have attained the age of 65 before the close of tax years beginning after December 31, 2012 and ending before January 1, 2017, reduced the floor to 7.5%. This rule is disregarded, however, for the purposes of computing the alternative minimum tax.

Act

The Act extends the 7.5% floor to any taxpayer, regardless of age, for taxable years beginning after December 31, 2016, but ending before January 1, 2019. The minimum tax preference would also not apply for those same years.

Effective for taxable years beginning after December 31, 2016.

Alimony deduction [Act §11051; I.R.C. §61, §71, §215] —

Current Law

Alimony payments generally are allowed as above-the line deductions for the payor, and are included in the income of the payee. However, alimony payments are neither deductible by the payor, nor includible in the income of the payee, if designated as such by the divorce decree or separation agreement.

Act

The Act repeals the deductibility of alimony payments, and repeals the inclusion of alimony payments in the payee's gross income.

Effective for a divorce decree or separation agreement executed after December 31, 2018, or for any divorce or separation instrument executed on or before December 31, 2018, and modified after that date, if the modification expressly provides that the amendments made by the section apply to such modification.

Moving expense deduction [Act §11049; I.R.C. §134, §217] —

Current Law

Taxpayers may claim deductions for moving expenses incurred in connection with starting a new job, regardless of whether or not the taxpayer itemizes his deductions. To qualify, the new workplace generally must be at least 50 miles farther from the former residence than the former place of work or, if the taxpayer had no former workplace, at least 50 miles from the former residence.

Act

The Act disallows the deduction for moving expenses during any taxable year beginning after December 31, 2017, and before January 1, 2026, other than for members of the Armed Forces..

Effective for taxable years beginning after December 31, 2017.

Miscellaneous itemized deductions [Act §11045; I.R.C. §67] —

Current Law

Miscellaneous itemized deductions may be deducted only to the extent that they exceed 2% of a taxpayer's adjusted gross income. Miscellaneous itemized deductions that are subject to the 2% floor of adjusted gross income include all itemized deductions except those specifically excluded in §67. Miscellaneous itemized deductions include: expenses for the production or collection of income, unreimbursed expenses attributable to the trade or business of being an employee, and other miscellaneous deductions.

Expenses for the production or collection of income include appraisal fees for a casualty loss or charitable contribution, casualty and theft losses from property used in performing services as an employee, clerical help and office rent in caring for investments, depreciation on home computers used for investments, excess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust, fees to collect interest and dividends, hobby expenses (but generally not more than hobby income), indirect miscellaneous deductions from pass-through entities, investment fees and expenses, loss on deposits in an insolvent or bankrupt financial institution, loss on traditional IRA or Roth IRAs, repayments of income, safe deposit box rental fees, service charge on dividend reinvestment plans, and trustee's fees for an IRA (if separately billed and paid).

Unreimbursed expenses attributable to the trade or business of being an employee include business bad debt of an employee, business liability insurance premiums, damages paid to a former employer for breach of an employment contract, depreciation on a computer a taxpayer's employer requires him to use in his work, dues to a chamber of commerce if membership helps the taxpayer perform his job, dues to professional societies, educator expenses, home office or part of a taxpayer's home used regularly and exclusively in the taxpayer's work, job search and expenses in the taxpayer's present occupation, laboratory brokerage fees, legal fees related to the taxpayer's job, license and regulatory fees, malpractice insurance premiums, medical examinations required by an employer, occupational taxes, passport fees for a business trip, repayment of an income aid payment received under an employer's plan, research expenses of a college professor, rural mail carriers' vehicle expenses, and subscriptions to professional journals and trade magazines related to a taxpayer's work, tools and supplies used in the taxpayer's work, purchase of travel, transportation, meals, entertainment, gifts, and local lodging, union dues and expenses, work clothes and uniforms, and work-related education.

Other miscellaneous deductions include repayments of income received under a claim of right (only subject to the two-percent floor if less than $3,000), repayments of Social Security benefits, and the share of deductible investment expenses from pass-through entities.

Act

The Act suspends all miscellaneous itemized deductions that are subject to the 2% floor for taxable years beginning after December 31, 2017, and before January 1, 2026. This suspension includes tax preparation expenses.

Effective for taxable years beginning after December 31, 2017.

Editor's Note: The House version of H.R. 1 would have just repealed the deduction for tax preparation expenses. The Act, following the Senate's provision, incorporates this change by suspending all miscellaneous itemized deductions subject to the 2% AGI limitation.

Deduction for living expenses incurred by Members of Congress [Act §13311; I.R.C. §162] —

Current Law

Section 162(a) deems the place of residence of a senator or representative within the state or district he represents to be his or her tax home and limits the member's annual deduction for living expenses to a maximum of $3,000.

Act

The Act provides that members of Congress are no longer allowed to deduct living expenses of up to $3,000 per year while away from their congressional districts or home states.

Effective for taxable years beginning after December 22, 2017.

Relief for 2016 disaster areas [Act §11028; I.R.C. §72(t), §165] —

Current Law

Taxpayer's distributions from qualified retirement plans are generally included in income. Unless an exception applies, a distribution prior to the taxpayer turning 591/2 is subject to a 10% additional tax.

Taxpayers may rollover distributions into another eligible retirement plan within 60 days to avoid income inclusion. The IRS has discretion to waive the 60-day period for taxpayers who fail to make the rollover in time.

Individuals may claim itemized deductions for personal casualty losses (i.e., losses not connected with a trade or business or entered into for profit), including property losses arising from fire, storm, shipwreck, or other casualty, or from theft. Certain tax legislation, including the Disaster Tax Relief and Airport and Airway Extension Act of 2017 (Pub. L. No. 115-63), provided for a special above-the-line deduction for personal casualty losses arising from specified natural disasters.

Act

The Act provides an exception to the 10% early withdrawal tax in the case of a qualified 2016 disaster distributions from retirement plans made on or after January 1, 2016, and before January 1, 2018, to individuals whose principal place of abode at any time during 2016 was in a 2016 disaster area and who sustained an economic loss by reason of the applicable 2016 disaster. Taxpayers can recognize income attributable to a distribution ratably over three years and have up to three years for recontributions of such distributions.

The “2016 disaster area” is defined to include any area for which the President has declared a major disaster under §401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act during calendar year 2016.

The Act also allows a deduction of net 2016 disaster area losses in excess of $500 without regard to the 10% adjusted gross income floor would apply for losses arising in taxable years beginning after December 31, 2015, and before January 1, 2018. These deductions are allowed in addition to the standard deduction.

Effective on December 22, 2017.

Exclusions and Taxable Compensation

Employee achievement awards [Act §13310; I.R.C. §74, §274] —

Current Law

Employee achievement awards are excluded from employees' income and deductible to the employer, within certain limitations. To qualify for the tax exclusion, an employee achievement award must be tangible personal property given in recognition of the employee's length of service or safety achievement at a ceremony that is a meaningful presentation. Furthermore, the conditions and circumstances cannot suggest a significant likelihood that the payment is disguised compensation. The employee is taxed to the extent that the cost (or value, if greater) of the award exceeds the employer's deduction for the award. The employer's deduction for employee achievement awards for any employee in any year cannot exceed $1,600 for qualified plan awards, and $400 otherwise. A qualified plan award is an employee achievement award that is part of an established written program of the employer, which does not discriminate in favor of highly compensated employees. In addition, the average award (not counting those of nominal value) may not exceed $400.

Prop. Reg. §1.274-8(c)(2) excludes from the definition of “tangible personal property” cash or gift certificate, or vacations, meals of lodging, tickets to theater and sporting events and stocks, bonds, and other securities.

Act

The Act codifies Prop. Reg. §1.274-8(c)(2) to exclude from the definition of tangible property cash, cash equivalents, gift cards, gift coupons, or gift certificates (other than arrangements conferring only the right to select and receive tangible personal property from a limited arrange of such items pre-selected or pre-approved by the employer), or vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items.

Effective for amounts paid or incurred after December 31, 2017.

Qualified bicycle commuting reimbursement [Act §11047; I.R.C. §132] —

Current Law

Qualified bicycle commuting reimbursements of up to $20 per month are excludible from an employee's gross income. Amounts that are excludible from gross income for income tax purposes also are excluded from wages for employment tax purposes.

Act

The Act repeals the exclusion from gross income and wages for qualified bicycle commuting reimbursements for taxable years beginning after December 31, 2017, and before January 1, 2026.

Effective for taxable years beginning after December 31, 2017.

Exclusion for qualified moving expense reimbursement [Act §11048; I.R.C. §132] —

Current Law

Qualified moving expense reimbursements provided by an employer to an employee are excluded from the employee's income.

Act

The Act includes moving expense reimbursements in an employee's gross income during any taxable year beginning after December 31, 2017, and before January 1, 2026, other than for active military who moves pursuant to a military order and incident to a permanent change of station.

Effective for taxable years beginning after December 31, 2017.

Increased contributions to ABLE accounts and saver's credit [Act §11024; I.R.C. §25B, §529A] —

Current Law

Qualified ABLE programs are tax-favored savings programs intended to benefit disabled individuals. They are established and maintained by state agencies (or instrumentalities thereof), and must meet certain conditions. For instance, contributions may be made to an ABLE account established for the purpose of meeting the qualified disability expenses of the designated beneficiary of the account and the program must limit a designated beneficiary to one ABLE account. Qualified ABLE programs are generally exempt from income tax, but are subject to taxes imposed on unrelated business income of a tax-exempt organization.

Contributions to ABLE accounts must be made in cash and are not deductible under federal tax law. Additionally, ABLE accounts cannot receive contributions for a tax year in excess of the annual gift tax exclusion amount ($14,000 per done for 2017), except in the case of a rollover from another ABLE account. Contributions must also not exceed limits imposed on accounts under the qualified tuition program of its respective state, and a qualified ABLE program must provide safeguards to ensure such. Income on ABLE accounts is not subject to current income tax.

The saver's credit is a nonrefundable tax credit for eligible taxpayers for qualified retirement savings contributions. The maximum annual contribution eligible for the credit equals $2,000 per individual, and the credit rate depends on the adjusted gross income (AGI) of the taxpayer. For tax years beginning in 2017, married taxpayers filing joint returns with AGI of $61,500 or less, taxpayers filing head of household returns with AGI of $46,125 or less, and all other taxpayers filing returns with AGI of $30,750 or less are eligible for the credit. As a taxpayer's AGI increases, the credit rate decreases, and is eventually unavailable.

The saver's credit is in addition to any deduction or exclusion that would otherwise apply with respect to the contribution. It offsets AMT liability and regular tax liability. The credit is available to individuals of at least 18 years of age, other than individuals who are full-time students or claimed as a dependent on another taxpayer's return.

Qualified retirement savings contributions include elective deferrals to a §401(k) plan, a §403(b) plan, a governmental §457 plan, a SIMPLE plan, or a SARSEP. Also included are contributions to a traditional or Roth IRA, and voluntary after-tax employee contributions to a qualified retirement plan or §403(b) plan, but not contributions to ABLE accounts. Contributions to the arrangement cannot exceed the lesser of an annual dollar amount (for example, in 2017, $5,500 in the case of an IRA of an individual under age 50) or the individual's compensation that is includible in income.

The amount of any contribution eligible for the credit is reduced by distributions received by the taxpayer from any retirement plan to which eligible contributions can be made during the tax year for which the credit is claimed, during the two-tax years before the year for which the credit is claimed, and during the period after the end of the tax year for which the credit is claimed and before the due date for filing the taxpayer's return for the year. Distributions rolled over to other retirement plans do not affect the credit.

Act

The Act increases the contribution limit to ABLE accounts with respect to contributions made by the designated beneficiary of the ABLE account. Once the overall limitation on contributions is reached, the designated beneficiary may contribute an additional amount, up to the lesser of the federal poverty line for a one-person household, or the individual's compensation for the tax year if made before January 1, 2026.

The Act requires that a designated beneficiary, or a person acting on behalf of a designated beneficiary, maintain adequate records to ensure that additional ABLE account contributions do not exceed the lesser of the federal poverty line for a one-person household or the individual's compensation for the tax year. The designated beneficiary, or a person acting on behalf of the designated beneficiary, is also obligated to ensure compliance with the additional contribution limitation.

The Act also permits the designated beneficiary to claim the saver's credit for contributions made to his or her ABLE account if made before January 1, 2026.

Effective for tax years beginning after December 22, 2017.

Treatment of certain individuals performing services in the Sinai Peninsula of Egypt [Act §11026; I.R.C. §112] —

Current Law

Members of the Armed Forces serving in combat zones are afforded a number of tax benefits. For example, certain military pay received for any month during which the member served in a combat zone, or was hospitalized as a result of serving in a combat zone, is excluded from gross income. Additionally, if a service member dies while serving in a combat zone as a result of wounds, disease, or injury incurred while doing so, he/she is exempt from taxes -- likewise, special estate tax rules apply. Special benefits are also available to surviving spouses in the event of a service member's death or missing status.

Act

The Act grants combat zone tax benefits to the Sinai Peninsula of Egypt, if (as of December 22, 2017) any member of the Armed Forces is entitled to special pay under §310 of title 37 of the United States Code (which relates to special pay for duty subject to hostile fire or imminent danger), for services performed there. This benefit lasts only during the period such entitlement is in effect.

Generally effective beginning June 9, 2015, but the portion of the Actrelated to wage withholding is effective for remuneration paid after December 22, 2017. However, the changes sunset for taxable years beginning before January 1, 2026.

Simplification and Reform of Savings, Pensions, Retirement

Roth IRA and traditional IRA recharacterization [Act §13611; I.R.C. §408A(d)] —

Current Law

An individual may recharacterize a contribution to a traditional IRA as a contribution to a Roth IRA, and vice versa. An individual also may recharacterize a conversion of a traditional IRA to a Roth IRA. The deadline for recharacterization generally is October 15 of the year following the conversion. When a recharacterization occurs, the individual is treated for tax purposes as not having made the conversion. The recharacterization must include any net earnings related to the conversion.

Act

The Act provides that the special rule that allows a contribution to one type of IRA to be recharacterized as a contribution to the other type of IRA will not apply to a conversion contribution to a Roth IRA. Thus, recharacterization could not be used to unwind a Roth conversion. However, recharacterization is still permitted with respect to other contributions.

Effective for plan years beginning after December 31, 2017.

Rollover of plan loan offsets [Act §13613; I.R.C. §402] —

Current Law

Employer-sponsored retirement plans may provide loans to employees. Unless the loan satisfies certain requirements in both form and operation, the amount of a retirement plan loan is a deemed distribution from the retirement plan. A deemed distribution of an unpaid loan balance is generally taxed as though an actual distribution occurred, including being subject to a 10% early distribution tax, if applicable. A deemed distribution is not eligible for rollover to another eligible retirement plan.

A plan may provide that an employee's obligation to repay a loan is accelerated and, if the loan is not repaid, the loan is cancelled and the amount in the employee's account balance is offset by the amount of the unpaid loan balance (loan offset).

A loan offset is treated as an actual distribution from the plan that is eligible for tax-free rollover to another eligible retirement plan within 60 days.

Act

The Act extends the period during which a qualified plan loan offset amount may be contributed to an eligible retirement plan as a rollover contribution from 60 days after the date of the offset to the due date (including extensions) for filing the federal income tax return for the taxable year in which the plan loan offset occurs.

Effective for plan loan offset amounts which are treated as distributed in taxable years beginning after December 31, 2017.

Length of service awards for public safety volunteers [Act §13612; I.R.C. §457] —

Current Law

Special rules apply to deferred compensation plans of State and local government and private, tax-exempt employers. However, an exception to these rules applies in the case of a plan that pays solely length of service awards to bona fide volunteers or their beneficiaries on account of qualified services performed by the volunteers. The exception applies only if the aggregate amount of length of service awards accruing for a bona fide volunteer with respect to any year of service does not exceed $3,000.

Act

The Act increases the aggregate amount of length of service awards for bona fide volunteers to $6,000, subject to adjustment for inflation after the first year being in effect. For a defined benefit plan,, the Act limits apply to the actuarial present value of the aggregate amount.

Effective for taxable years beginning after December 31, 2017.

Taxpayer Rights and Tax Administration

Extend time for contesting IRS levy [Act §11071; I.R.C. §6343, §6532] —

Current Law

The IRS may levy on all property and rights to property belonging to any person who is liable to pay any tax and neglects or refuses to pay such tax. In addition, any property that is attached by a federal tax lien or by any other tax lien under the collection provisions of the Internal Revenue Code is subject to levy. Thus, the IRS can levy on property subject to a federal tax lien, even if the property has been sold or transferred by the taxpayer.

If the IRS has wrongfully levied against property, the IRS has the authority to return the property. The IRS can return the levied property at any time, provided that the IRS still has possession of the property. If the levied property is money or property which has been sold, the IRS can only return an amount equal to the levied money or the sale proceeds within nine months after the date of the levy.

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Act

The Act gives the IRS two years, instead of nine months, to return the monetary proceeds from the sale of property that has been wrongfully levied upon.

Additionally, the Act provides that any person who claims an interest in levied property that was wrongfully levied upon has two years, instead of nine months, to bring a civil action for wrongful levy.

Effective with respect to (1) levies made after the date of enactment, and (2) levies made on or before December 22, 2017, provided that the nine-month period has not expired as of such date.

Health Care

Elimination of shared responsibility payment for individual failing to maintain minimum essential coverage [Act §11081; I.R.C. §5000A] —

Current Law

Individuals are personally responsible for obtaining for themselves and their dependents health care coverage on a monthly basis that meets the requirements for minimum essential coverage. A tax penalty applies unless the individual purchases health insurance or is exempt from the penalty.

Act

The Act reduces the amount of the individual shared responsibility payment enacted as part of the Affordable Care Act to zero.

Effective for months beginning after December 31, 2018.

ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAXES

Estate and Gift Taxes [Act §11061; I.R.C. §1014, §2001-§2210, §2502, §2505, §2801] —

Current Law

There is an integrated estate and gift tax. Estate and gift taxes are imposed at a rate of 40%. There is an annual exclusion of $10,000 per donee for lifetime gifts, indexed for inflation ($14,000 for 2017). The first $5 million of transferred property is exempt from estate and gift taxes. The $5 million unified credit basic exclusion amount is indexed for inflation ($5.49 million for 2017). Although an estate tax marital deduction generally is denied for property passing to a surviving spouse who is not a citizen of the United States, an exception is provided for property passing to a qualified domestic trust for such spouse. Estate taxes are imposed on lifetime distributions from a qualified domestic trust to the non-citizen surviving spouse and on the value of the property remaining in the trust at such spouse's death. A 40% tax is imposed on certain gifts and bequests received from former U.S. citizens or former long-term U.S. residents classified as "covered expatriates." Beneficiaries of an estate take an income tax basis in property received equal to its fair-market value at the time of the decedent's death (sometimes referred to as a "stepped-up" basis). Donees generally take a carryover basis when property is received by gift (that is, donees generally take the donor's basis).

Act

The Act increases the estate and gift tax unified credit basic exclusion amount to $10,000,000 (subject to inflation adjustments) for taxable years beginning after December 31, 2017, and before January 1, 2026.

Effective for decedents dying and gifts made after December 31, 2017.

Generation-skipping Transfer Tax [Act §11061; I.R.C. §2601-§2664] —

Current Law

There is a generation-skipping transfer tax of 40% for property that is transferred beyond one generation, whether by gift or bequest. The first $5 million of transferred property is exempt from generation-skipping transfer taxes. The $5 million GST exclusion amount is indexed for inflation ($5.49 million for 2017).

Act

The Act increase the GST exemption amount to $10,000,000 (subject to inflation adjustments) for taxable years beginning after December 31, 2017, and before January 1, 2026.

Effective for decedents dying and gifts made after December 31, 2017.

ALTERNATIVE MINIMUM TAX

Corporate alternative minimum tax [Act §12001, §12002; I.R.C. §53, §55-§59] —

Current Law

Taxpayers must compute their income for purposes of the regular income tax, then recompute their income for purposes of the alternative minimum tax (AMT). Corporations with average gross receipts equal to or in excess of $7.5 million over the preceding three tax years are subject to the alternative minimum tax (AMT). A taxpayer's tax liability is the greater of their regular tax liability or their AMT liability.

Corporations, and in some cases noncorporate taxpayers, receive a credit for AMT paid (the prior-year minimum tax credit), which they can carry forward and claim against regular tax liability in future tax years, to the extent such liability exceeds AMT in a particular year.

Act

The Act repeals the corporate alternative minimum tax for tax years beginning after December 31, 2017. Under the Act, if a corporate taxpayer has prior-year minimum tax credit carryforwards, the taxpayer would be able to use the credit carryforwards to offset the regular tax liability for any tax year. In addition, the taxpayer may claim a refund of 50% of the remaining credits (to the extent the credits exceed the regular tax liability for the year) in tax years beginning in 2018, 2019, and 2020, and may claim a refund of all remaining credits in the tax year beginning in 2021. The AMT refundable credit amount will be prorated for short tax years. The AMT credit limitation is increased by the AMT refundable credit amount in tax years 2018 through 2021.

Effective for taxable years beginning after December 31, 2017.

Individual alternative minimum tax [Act §12003; I.R.C. §55] —

Current Law

Taxpayers must compute their income for purposes of the regular income tax, then recompute their income for purposes of the alternative minimum tax (AMT).

For individuals, estates and trusts, the AMT has a 26% bracket and a 28% bracket. The corporate AMT rate is 20%. In computing the AMT, only alternative minimum taxable income (AMTI) above an AMT exemption amount is taken into account, but AMTI represents a broader base of income than regular taxable income because many deductions and tax preferences are disallowed for AMT purposes.

Act

The Act increases the exemption amount threshold to $109,400 for married taxpayers filing a joint return (half this amount for married taxpayers filing a separate return), and $70,300 for all other taxpayers (other than estates and trusts) for tax years beginning after December 31, 2017, and before January 1, 2026.

The Act also increases the phase-out threshold to $1,000,000 for married taxpayers filing a joint return, and $500,000 for all other taxpayers (other than estates and trusts) beginning after December 31, 2017, and before January 1, 2026.

Both the exemption amount threshold amounts and the phase-out threshold amounts are indexed for inflation.

Effective for taxable years beginning after December 31, 2017.

BUSINESS TAX REFORM

Tax Rates and Related Reforms

Reduction in corporate tax rate [Act §13001; I.R.C. §11] —

Current Law

A corporation's regular tax liability is determined by applying the following rates: 15% for $0-$50,000 of taxable income, 25% for $50,001-$75,000 of taxable income, 34% for $75,001-$10,000,000 of taxable income and 35% for excess of $10,000,000 of taxable income. The 15% and 25% rates are phased out for corporations with taxable income between $100,000 and $335,000 and the 34% rate is gradually phased out for corporations with taxable income between $15,000,00 and $18,333,333. Additionally, personal service corporations are not entitled to use the graduated corporate rates below the 35% rate.

Act

The Act decreases the corporate tax rate to 21% effective for taxable years beginning after December 31, 2017, and provides clarification on the normalization of excess tax reserves resulting from the reduction of corporate income tax rates. The Act applies the new corporate rate to personal service corporations.

The Act repeals the maximum corporate tax rate on net capital gain as obsolete. For taxpayers subject to the normalization method of accounting (e.g., regulated public utilities), the Act provides for the normalization of excess deferred tax reserves resulting from the reduction of corporate income tax rates (with respect to prior depreciation or recovery allowances taken on assets placed in service before December 22, 2017).

Effective for taxable years beginning after December 31, 2017.

Reduction of dividends received deduction to reflect lower corporate income tax rates [Act §13002; I.R.C. §1, §243] —

Current Law

Corporations which receive dividends from other taxable corporations are generally allowed a deduction equal to 70% of the dividends received. In the case of any dividend received from a 20%-owned corporation, the amount of the deduction is equal to 80% of the dividend received.

For this purpose, certain preferred stock is not taken into account. If a dividend is received from a corporation that is a member of the same affiliated group, a corporation is generally allowed a deduction equal to 100% of the dividend received.

Act

The Act clarifies that the 80% dividends received deduction is reduced to 65% and the 70% dividends received deduction is reduced to 50%.

Effective for taxable years beginning after December 31, 2017.

Pass-through Entities

Pass-through business income of individuals [Act §11011; I.R.C. §1, §199A (new), §701, §1366, §1402] —

Current Law

Businesses organized as sole proprietorships, partnerships, limited liability companies and S corporations are generally treated as pass-through entities subject to tax at the individual owner or shareholder level rather than the entity level. Net income earned by owners of these entities is reported on their individual income tax returns and is subject to ordinary income tax rates, up to the top individual marginal rate of 39.6%.

For purposes of the self-employment tax, net earnings from self-employment is defined as gross income less deductions from a trade or business carried on by an individual, including the distributive share of income or loss from a trade or business of any partnership in which the individual is a partner. The distributive share of a limited partner is generally excluded, however. An S corporation shareholder's pro rata share of S corporation income is not subject to self-employment tax.

Act

The Act allows individual taxpayers to deduct 20% of the qualified business income (QBI) from a partnership, S corporation, or sole proprietorship, as well as 20% of the total qualified REIT dividends and qualified publicly traded partnership income. Special rules apply to specified agricultural and horticultural cooperatives. A limitation based on W-2 wages paid is phased in above a threshold amount of taxable income. A disallowance of the deduction with respect to specified service trades or businesses is also phased in above the threshold amount of taxable income.

The deduction is available to both itemizers and non-itemizers. The deduction applies to reduce taxable income and is not allowed in computing adjusted gross income.

Determination of Taxpayer's Deduction The taxpayer's deduction for the tax year is equal to the sum of (1) the lesser of (a) the taxpayer's combined qualified business income amount, or (b) an amount equal to 20% of the excess of the taxpayer's taxable income over any net capital gain and qualified cooperative dividends, plus (2) the lesser of (a) 20% of qualified cooperative dividends, or (b) taxable income (reduced by net capital gain). The taxpayer's deduction may not exceed the taxpayer's taxable income (reduced by net capital gain) for the tax year.

Combined Qualified Business Income Amount The taxpayer's combined qualified business income amount for the tax year is (1) the sum of the deductible QBI amounts determined for each qualified trade or business carried on by the taxpayer, plus (2) 20% of the taxpayer's qualified REIT dividends and qualified publicly traded partnership income. The deductible QBI amount for each qualified trade or business generally is equal to the lesser of (1) 20% of the taxpayer's QBI with respect to the trade or business, or (2) the W-2 wage limitation.

Qualified Business Income (QBI) QBI is defined as the net amount of qualified items of income, gain, deduction, and loss with respect to the qualified trade or business of the taxpayer. A qualified trade or business is defined as any trade or business other than a specified service trade or business or the trade or business of being an employee. Items of income, gain, deduction, and loss are qualified items only to the extent (1) they are included or allowed in the determination of the taxpayer's taxable income for the tax year, and (2) they are effectively connected with the conduct of a trade or business within the United States or Puerto Rico. QBI does not include specified investment-related items of income, gain, deduction, and loss. QBI also does not include (1) any amount paid by an S corporation that is treated as reasonable compensation of a taxpayer, (2) any guaranteed payment by a partnership to a taxpayer for services rendered with respect to the trade or business, or (3) any amount paid by a partnership to a taxpayer acting other than in his or her capacity as a partner for services.

If the net amount of QBI from all qualified trades or businesses during the tax year is a loss, it is carried forward as a loss from a qualified trade or business in the next tax year. Any deduction of the taxpayer allowed in a subsequent year is reduced (but not below zero) by 20% of any such carryover qualified business loss.

W-2 Wage Limitation The W-2 wage limitation is equal to the greater of (1) 50% of the W-2 wages with respect to the trade or business, or (2) the sum of (a) 25% of the W-2 wages with respect to the trade or business, plus (b) 2.5% of the unadjusted basis (immediately after acquisition) of all qualified property. However, if the taxpayer's taxable income is below an applicable threshold amount, the W-2 wage limitation does not apply to limit the taxpayer's deduction. The W-2 wage limitation phases in for a taxpayer with taxable income in excess of the applicable threshold amount. Editor's Note: The second alternative for calculating the W-2 wage limitation was added during the conference negotiations and permits real estate businesses with large capital investments but few employees to qualify for a significant deduction under this provision.

W-2 wages are defined as the total wages subject to wage withholding, elective deferrals, and deferred compensation paid by the qualified trade or business with respect to employment of its employees during the calendar year ending during the tax year of the taxpayer. W-2 wages do not include (1) any amount that is not properly allocable to the QBI as a qualified item of deduction, and (2) any amount that was not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for filing such return.

Qualified property is defined as tangible property of a character subject to depreciation (1) that is held by, and available for use in, the qualified trade or business at the end of the tax year, (2) that is used in the production of QBI, and (3) for which the depreciable period has not ended before the end of the tax year. The depreciable period with respect to qualified property is defined as the period beginning on the date the property is first placed in service by the taxpayer and ending on the later of (1) the date 10 years after that date, or (2) the last day of the last full year in the applicable recovery period that would apply to the property under §168 (without regard to §168(g)).

Specified Service Trade or Business Exclusion Generally, a specified service trade or business is excluded from the definition of qualified trade or business. Therefore, no deduction is generally allowed with respect to the income of a specified service trade or business. However, if a taxpayer's taxable income is below an applicable threshold amount, the exclusion does not apply and the taxpayer is allowed a deduction with respect to the income of a specified service trade or business. The specified service trade or business exclusion phases in for a taxpayer with taxable income in excess of the applicable threshold amount.

A specified service trade or business is defined 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 one or more of its employees or owners, or which involves the performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities.

Threshold Amounts and Phase-in For purposes of the W-2 wage limitation and the specified service trade or business exclusion, the threshold amounts are $315,000 for joint filers and $157,500 for all other taxpayers (indexed for inflation). Editor's Note: The conference report noted that the conferees reduced these threshold amounts to deter high-income taxpayers from attempting to convert wages or other compensation for personal services into income eligible for the 20% deduction.

The W-2 wage limitation and the specified service trade or business exclusion are phased in for taxpayers with taxable income in excess of the applicable threshold amount. They are fully phased in for joint filers with taxable income in excess the threshold amount (currently $315,000) plus $100,000, and for other taxpayers with taxable income in excess of the threshold amount (currently $157,500) plus $50,000.

Qualified REIT Dividends and Qualified Publicly Traded Partnership Income A deduction is allowed for 20% of a taxpayer's total amount of qualified REIT dividends and qualified publicly traded partnership income. Qualified REIT dividends are generally defined as any dividends received from a REIT other than any portion of a dividend received from a REIT that is a capital gain dividend or a qualified dividend. Qualified publicly traded partnership income is generally

defined as the sum of (1) the net amount of the taxpayer's allocable share of each qualified item of income, gain, deduction, and loss from a publicly traded partnership not treated as a corporation, and (2) gain recognized by the taxpayer on disposition of its interest in the publicly traded partnership that is treated as ordinary income.

Specified Agricultural or Horticultural Cooperatives A deduction is allowed to any specified agricultural or horticultural cooperative equal to the lesser of (1) 20% of the cooperative's taxable income for the tax year, or (2) the greater of (a) 50% of the W-2 wages paid by the cooperative with respect to its trade or business, or (b) the sum of (i) 25% of the W-2 wages paid by the cooperative with respect to its trade or business, plus (ii) 2.5% of the unadjusted basis (immediately after acquisition) of qualified property of the cooperative. A specified agricultural or horticultural cooperative is defined as an organization to which subchapter T applies that is engaged in (1) the manufacturing, production, growth, or extraction, in whole or significant part, of any agricultural or horticultural product, (2) the marketing of agricultural or horticultural products that its patrons have so manufactured, produced, grown, or extracted, or (3) the provision of supplies, equipment, or services to farmers or organizations described in (1) and (2).

Application to Partnerships and S corporations In the case of a partnership or S corporation, the provision applies at the partner or shareholder level. Each partner takes into account the partner's allocable share of each qualified item of income, gain, deduction, and loss and is treated as having W-2 wages for the tax year equal to the partner's allocable share of W-2 wages of the partnership. Each shareholder of an S corporation takes into account the shareholder's pro rata share of each qualified item of income, gain, deduction, and loss and is treated as having W-2 wages for the tax year equal to the shareholder's pro rata share of W-2 wages of the S corporation.

Application to Trusts and Estates Trusts and estates are eligible for the deduction. For purposes of the W-2 wage limitation, rules similar to the rules in present law §199 (as in effect on December 1, 2017) apply for apportioning any W-2 wages and unadjusted basis of qualified property between fiduciaries and beneficiaries.

Effective and Expiration Dates Effective for taxable years beginning after December 31, 2017, but terminates for tax years beginning after December 31, 2025.

Technical termination of partnerships [Act §13504; I.R.C. §708] —

Current Law

A partnership may experience a technical termination if 50% or more of the total interests in partnership capital and profits is sold or exchanged within a 12-month period. The partnership's existence does not necessarily end upon a technical termination. Generally, however, the partnership's taxable year closes, partnership-level elections cease to apply, and partnership depreciation recovery periods restart.

Act

The Act repeals the technical termination rule for partnerships where more than 50% of the total capital and profits interests are sold or exchanged.

Effective for partnership taxable years beginning after December 31, 2017.

Carried interest [Act §13309; I.R.C. §83, §1061 (new)] —

Current Law

An owner of a partnership interest who receives payments in connection with the performance of services is entitled to long-term gain treatment upon the sale of partnership interests held for greater than one year. This is typically known as a carried interest. [I.R.C. §1222]

Act

The Act creates a three-year holding period requirement for long-term capital gain and loss for certain service-based partnership interests. This rule specifically applies to businesses which consist of engaging in capital market transactions or other specified investments. Certain equity interests and interests held by corporations are exempt. The exempt interest will be measured by the amount of capital contributed to such partnership interest. The provision does not apply to income or gain attributable to any asset not held for portfolio investment on behalf of third party investors.

The Act applies notwithstanding the rules of §83 or any election in effect under §83(b).

Effective for taxable years beginning after December 31, 2017.

Tax gain on the sale of a partnership interest on look-through basis [Act §13501; I.R.C. §864, §1446] —

Current Law

A foreign person engaged in a trade or business in the United States is taxed on income that is "effectively connected" with the conduct of that trade or business ("effectively connected gain or loss"). Partners in a partnership are engaged in the conduct of a trade or business within the United States if the partnership is so engaged.

The extent to which the income, gain, or loss is derived from assets used in or held for use in the conduct of the U.S. trade or business and whether the activities of the trade or business were a material factor in the realization of the income, gain, or loss (the "asset use" and "business activities" tests) are factors considered in determining whether income is effectively connected. In determining whether the asset use or business activities tests are met, due regard is given to whether such assets or such income, gain, or loss were accounted for through such trade or business.

Special rules apply to treat gain or loss from disposition of U.S. real property interests as effectively connected with the conduct of a U.S. trade or business. Consideration received by the nonresident alien or foreign corporation for all or part of its interest in a partnership that is attributable to a U.S. real property interest is considered to be received from the sale or exchange in the United States of such property. Gain attributable to sales of U.S. real property interests may be subject to withholding tax of 10% of the amount realized on the transfer.

Act

The Act provides that gain or loss from the sale or exchange of a partnership interest is effectively connected with a U.S. trade or business 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. Any gain or loss from the hypothetical asset sale by the partnership would be allocated to partnership interests in the same manner as nonseparately stated income and loss.

The Act requires the transferee of a partnership interest to withhold 10% of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that the transferor is not a nonresident alien individual or foreign corporation. If the transferee fails to withhold the correct amount, the partnership is required to deduct and withhold from distributions to the transferee partner an amount equal to the amount the transferee failed to withhold. Withholding is not required if the transferor furnishes an affidavit to the transferee stating that the transferor is not a foreign person.

The Act authorizes the IRS to issue regulations to carry out the withholding rules in the case of publicly traded partnerships.

The Act clarifies that regulatory authority is provided with respect to exchanges described in §332, §351, §354, §355, §356, or §361.

Effective date for sales and exchanges after November 27, 2017, but withholding provisions apply to sales, exchanges, or other dispositions occurring after December 31. 2017.

Substantial built-in loss in the case of transfer of partnership interest [Act §13502; I.R.C. §743] —

Current Law

A partnership does not adjust the basis of partnership property following the transfer of a partnership interest unless the partnership has made a one-time §754 election for basis adjustments or the partnership has a substantial built-in loss immediately after the transfer.

If an election is in effect or if the partnership has a substantial built-in loss immediately after the transfer, adjustments are made with respect to the transferee partner to account for the difference between the transferee partner's proportionate share of the adjusted basis of the partnership property and the transferee's basis in its partnership interest.

A substantial built-in loss exists if the partnership's adjusted basis in its property exceeds by more than $250,000 the fair market value of the partnership property. Certain securitization partnerships and electing investment partnerships are not treated as having a substantial built-in loss in certain instances, and thus are not required to make basis adjustments to partnership property. For electing investment partnerships, in lieu of the partnership basis adjustments, a partner-level loss limitation rule applies.

Act

The Act modifies the definition of a substantial built-in loss for §743(d) purposes, affecting transfers of partnership interests. In addition to the present-law definition, a substantial built-in loss also exists if the transferee would allocate a net loss in excess of $250,000 upon a hypothetical disposition by the partnership of all partnership's assets in a fully taxable transaction for cash equal to the assets' fair market value, immediately after the transfer of the partnership interest.

Effective for transfers of partnership interests after December 31, 2017.

Charitable contributions and foreign taxes taken into account in determining limitation on allowance of partner's share of loss [Act §13503; I.R.C. §704] —

Current Law

A partner's distributive share of partnership loss is limited to the adjusted basis of the partner's interest in the partnership taxable year in which the loss occurred. However, under current regulations, foreign taxes paid and charitable contributions made are not taken into account in applying the basis limitation on partner losses.

Act

The Act modifies the basis limitation rules on partner losses to apply to charitable contributions and foreign taxes. The Act clarifies that the basis limitation on partner losses does not apply to the excess of fair market value over adjusted basis on charitable contributions of appreciated property.

Effective for partnership taxable years beginning after December 31, 2017.

Qualifying beneficiaries of an electing small business trust [Act §13541; I.R.C. §1361]

Current Law

An electing small business trust (ESBT) is an eligible shareholder of an S corporation. Eligible beneficiaries of ESBTs are individuals, estates, and certain charitable organizations which are eligible to directly hold S corporation stock. Nonresident alien individuals may not be shareholders or potential current beneficiaries of an ESBT.

Act

Under the Act, a nonresident alien individual may be a potential current beneficiary of an ESBT. The provision would not permit a nonresident alien individual to be an S corporation shareholder.

Effective on January 1, 2018.

Charitable contribution deduction for electing small business trusts [Act §13542; I.R.C. §170, §641, §642] —

Current Law

An electing small business trust ("ESBT") may be a shareholder of an S corporation. The portion of an ESBT that consists of the stock of an S corporation is treated as a separate trust and generally is taxed on its share of the S corporation's income at the highest rate of tax imposed on individuals. Because an ESBT is a trust, the deduction for charitable contributions applicable to trusts, rather than the deduction applicable to individuals, applies to the trust.

Generally, a trust is allowed a charitable contribution deduction for amounts of gross income, without limitation, which pursuant to the terms of the governing instrument are paid for a charitable purpose. No carryover of excess contributions is allowed. An individual is allowed a charitable contribution deduction limited to certain percentages of adjusted gross income generally with a five-year carryforward of amounts in excess of this limitation.

Act

The Act provides that the charitable contribution deductions of an ESBT is governed by the rules applicable to individuals. As a result, the percentage limitations and carryforward provisions that apply to individuals also applies to the portion of an ESBT holding S corporation stock.

Effective for taxable years beginning after December 31, 2017.

S corporation conversions to C corporations [Act §13543; I.R.C. §481, §1371] —

Current Law

Distributions from a terminated S corporation are treated as paid from its accumulated adjustment account if made during the post-termination transition period which ends on the later of one year from the last day the corporation was an S corporation, or the due date for filing the last return of the S corporation (including extensions).

Act

The Act extends the period for which distributions from a terminated S corporation would be treated as paid from its accumulated adjustment account and from its earnings and profits on a pro-rata basis. Adjustments under §481(a) due to the termination is accounted for ratably over a 6-year period.

Effective for S corporations which revoke their S corporation elections during the 2-year period beginning on December 22, 2017, and have the same owners on both December 22, 2017, and the revocation date.

Cost Recovery

Bonus depreciation [Act §13201; I.R.C. §168(k)] —

Current Law

Taxpayers receive an additional depreciation deduction in the year in which it places certain “qualified property” in service (bonus depreciation), effective for property placed in service through 2019 (2020 for certain qualified property with a longer production period). The amount of bonus depreciation is 50% of the cost of such property placed in service during 2017 and phases down to 40% in 2018 and 30% in 2019. Qualified property that is eligible for bonus depreciation is tangible personal property with a recovery period of 20 years or less under the modified accelerated cost recovery system (MACRS), certain off-the-shelf computer software, water utility property, and qualified improvement property.

“Specified plants” (certain trees, vines, and plants bearing fruit or nuts) are also eligible for bonus depreciation, when planted or grafted rather than when placed in service.

Finally, to be eligible for bonus depreciation, the original use of the property must begin with the taxpayer.

Taxpayers may elect out of bonus depreciation. Taxpayers can elect to accelerate the use of their AMT credits in lieu of deducting bonus depreciation.

The costs of any qualified film or television production, and the costs of any qualified live theatrical production, are allowed as a deduction (subject to the dollar limitation described below) if the taxpayer so elects, even if it would otherwise be capitalized.

Taxpayers receive an additional depreciation deduction in the year in which it places certain “qualified property” in service (bonus depreciation), effective for property placed in service through 2019 (2020 for certain qualified property with a longer production period). The amount of bonus depreciation is 50% of the cost of such property placed in service during 2017 and phases down to 40% in 2018 and 30% in 2019. Qualified property that is eligible for bonus depreciation is tangible personal property with a recovery period of 20 years or less under the modified accelerated cost recovery system (MACRS), certain off-the-shelf computer software, water utility property, and qualified improvement property.

Act

The Act extends the availability of bonus depreciation for qualified property and specified fruit- and nut-bearing plants for three additional years, and increases the bonus depreciation percentage to 100%, effectively allowing taxpayers to deduct immediately the full cost of qualified property acquired and placed in service (and specified plants planted or grafted) after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property).

The Act begins to phase down the percentage that may be expensed for property placed in service after January 1, 2023, as follows:

For property placed in service after December 31, 2022, and before January 1, 2024, 80% expensing. For property placed in service after December 31, 2023, and before January 1, 2025, 60% expensing. For property placed in service after December 31, 2024, and before January 1, 2026, 40% expensing. For property placed in service after December 31, 2025, and before January 1, 2027, 20% expensing.

For property with longer production periods, placed in service after December 31, 2023, and before January 1, 2025, 80% expensing. For such property place in service after December 31, 2024, and before January 1, 2026, 60% expensing. For such property placed in service after December 31, 2025, and before January 1, 2027, 40% expensing. For such property placed in service after December 31, 2026, and before January 1, 2028, 20% expensing.

For plants planted or grafted after December 31, 2022, and before January 1, 2024, 80% expensing. For plants planted or grafted after December 31, 2023, and before January 1, 2025, 60% expensing. For plants planted or grafted after December 31, 2024, and before January 1, 2026, 40% expensing. For plants planted or grafted after December 31, 2025, and before January 1, 2027, 20% expensing.

Alternatively, the Act allows taxpayers to elect 50% in lieu of 100% expensing for qualified property placed in service during the first tax year beginning after September 27, 2017.

The current law phase-down bonus depreciation percentage still applies to qualified property acquired by the taxpayer before September 28, 2017, and placed in service by the taxpayer after September 27, 2017 as well as the present-law phase-down of the §280F increase amount in the limitation on the depreciation deductions allowed with respect to certain passenger automobiles acquired before September 28, 2017, and placed service after September 27, 2017.

The definition of qualified property is expanded to allow used property acquired by the taxpayer to be eligible for bonus depreciation, provided the property was not used by the taxpayer before the taxpayer acquired it. The definition of qualified property is also amended to exclude property used in a real estate trade or business and certain regulated public utility property.

The Act also amends the definition of qualified property to exclude any property used in a trade or business that had floor plan financing indebtedness that was taken into account in the business interest deduction limitation.

The definition of qualified property is expanded to include qualified film, television, and live theatrical productions initially released, broadcast, or staged live after September 27, 2017. A production is considered placed in service at the time of initial release, broadcast, or live staged performance (i.e., at the time of the first commercial exhibition, broadcast, or live staged performance of a production to an audience).

The Act maintains the increased first-year depreciation amount of $8,000 for passenger automobiles. If the automobile is acquired before September 28, 2017, and placed in service after September 27, 2017, the phase-down for future years depreciation amounts remains.

With the elimination of the corporate alternative minimum tax, a corporate taxpayer's election to claim prior year minimum tax credits in lieu of bonus deprecation is repealed.

Generally be effective for qualified property acquired and placed in service after September 27, 2017, and specified plants planted or grafted after September 27, 2017. Property is not be treated as acquired after the date on which a written binding contract for its acquisition is entered into.

Depreciation limitations on luxury automobiles and personal use property [Act §13202; I.R.C. §280F] —

Current Law

The annual cost recovery deduction for certain passenger automobiles is limited. This is commonly referred to as the luxury automobile depreciation limitation. For passenger automobiles placed in service in 2017 for which the additional first-year depreciation deduction under §168(k) is not claimed, a taxpayer may depreciate a maximum amount of $3,160 for the year in which the vehicle is placed in service, $5,100 for the second year, $3,050 for the third year, and $1,875 for the fourth and later years in the recovery period. This limit is indexed for inflation and applies to the aggregate deduction for depreciation and §179 expensing.

Passenger automobiles eligible for the additional first-year depreciation allowance in 2017 may depreciate an additional $8,000 in the first year the vehicle is placed in service. For this purpose, passenger automobiles include any four-wheeled vehicles manufactured primarily for use on public streets, roads, and highways, and which are rated at 6,000 pounds unloaded gross vehicle weight or less. The increased depreciation limit also applies to a truck (including a sport utility vehicle) or van rated at 6,000 pounds or less.

Special rules apply to listed property. Listed property generally includes passenger automobiles, other property used as a means of transportation, property generally used for entertainment, recreation, or amusement, any computer or peripheral equipment, and any other property of a type specified in Treasury regulations. First, if during the year in which the property is placed in service, the use of the property for trade or business purposes does not exceed 50% of the total use of the property, then the depreciation deduction for that property is determined under the alternative depreciation system. This requires the use of the straight-line method, and a recovery period equal to the class life of the property. Second, for those individuals who lease or own listed property and use it in the connection with the performance of services as an employee, no depreciation deduction, expensing allowance, or deduction for lease payments is available unless the use of the property is for the convenience of the employer and required as a condition of employment.

With respect to listed property, no deduction is allowed unless the taxpayer can adequately substantiate the expense and business usage of the property. A taxpayer must substantiate every element of each expenditure or use of listed property– typically including the amount of the expenditure and the amount of business or investment use (miles for automobiles), and the total use of the property, the date of the expenditure or use, and the business purposes for the expenditure or use, although the level of substantiation can vary from case to case.

Act

The Act increases the depreciation limits that apply to listed property. For passenger automobiles placed in service in 2018 and for which the additional first-year depreciation deduction is not claimed, the maximum amount of allowable depreciation would be increased to $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. The amounts are indexed for inflation for automobiles placed in service after 2018.

The Act also removes computer or peripheral equipment from the definition of listed property, thus removing such equipment from the heightened substantiation requirements that apply to listed property.

Effective for property place in service after December 31, 2017.

Depreciation of certain farm property [Act §13203; I.R.C. §168] —

Current Law

Generally taxpayers must capitalize the cost of property used in a trade or business or held for the production of income and to recover such cost over time through annual deductions for depreciation or amortization. Tangible property is generally depreciated under the modified accelerated cost recovery system (MACRS). The applicable recovery period for an asset is determined in part by the statute and in part by treasury guidance, and the "class life" of an asset is determined by the "type of property," which in turn dictates the applicable recovery period.

The MACRS recovery periods applicable to most tangible personal property range from three to 20 years and generally use the 200% and 150% declining balance methods in calculating depreciation – switching to the straight-line method when it yields a larger depreciation allowance. The recovery period for most nonresidential real property is 39 years, and 27.5 years for residential rental property. Both require the use of the straight-line depreciation method.

Property used in a farming business is assigned various recovery periods in the same manner as other business property. For example, depreciable assets used in agricultural activities like machinery and equipment, grain bins, and fences used in the production of crops or plants, vines, and trees; livestock; the operation of farm dairies, nurseries, greenhouses, sod farms, mushrooms cellars, cranberry bogs, apiaries, and fur farms; and the performance of agriculture, animal husbandry, and horticultural services, are assigned a recovery period of seven years. But land improvements like drainage facilities, paved lots, and water wells are assigned a 15-year recovery period. New farm machinery or equipment (other than grain bins, cotton ginning assets, fences, and other land improvements) used in a farming business the original use of which commenced with the taxpayer after December 31, 2008, and which was placed in service before January 1, 2010, is assigned a 5-year recovery period.

With some exceptions, any property used in a farming business is subject to the 150% declining balance method.

Certain taxpayers engaged in the business of farming, and who elect to deduct preproductive period expenditures, are required to depreciate all farming assets using the alternative depreciation system (using longer recovery periods and the straight-line method).

Act

The Act shortens, from seven years to five years, the recovery period for any machinery or equipment used in the farming business (not including grain bins, cotton ginning assets, fences, and other land improvements), the original use of which commences with the taxpayer and is

placed in service after December 31, 2017. Additionally, the Act repeals the requirement that the 150% declining balance method be used to depreciate property used in a farming business (i.e., 3-, 5-, 7-, and 10-year property). However, under the Act, the 150% declining balance method still applies to 15-year or 20-year property used in the farming business to which the straight-line method does not apply, and to property for which the taxpayer elects to apply the 150% declining balance method.

Effective for property placed in service after December 31, 2017, in taxable years beginning after such date.

Applicable recovery period for real property; use of ADS for electing farming businesses [Act §13204, §13205; I.R.C. §168] —

Current Law

Taxpayers are generally required to capitalize the cost of property used in a trade or business or held for the production and recover such cost over time through annual deductions for depreciation or amortization. Tangible property is generally depreciated under the modified accelerated cost recovery system (MACRS). The applicable recovery period for an asset is determined in part by the statute and in part by treasury guidance, and the "class life" of an asset is determined by the "type of property" which in turn, dictates the recovery period.

The MACRS recovery periods applicable to most tangible personal property range from three to 20 years and generally use the 200% and 150% declining balance methods in calculating depreciation – switching to the straight line method where it yields a larger depreciation balance in the first year. The recovery period for most nonresidential real property is 39 years, and 27.5 years for residential rental property. Both require the use of the straight line depreciation method.

Depreciation of an asset begins when the asset is deemed to be placed in service under the applicable convention. Under MACRS, nonresidential real property, residential rental property, and any railroad grading or tunnel bore are generally subject to the mid-month convention, which treats all property placed in service during any month as placed in service on the mid-point of such month. Other property is typically subject to the half-year convention which treats all property placed in service during any taxable year as placed in service on the mid-point of such taxable year. A special mid-quarter convention applies to property placed in service during the last three months of a taxable year.

The recovery period for any addition or improvement to real or personal property begins on the later of, the date on which the addition or improvement is placed in service, or the date on which the property the addition or improvement was made to, is placed in service. MACRS deductions for additions or improvements to any property are computed in the same manner as the deduction for the underlying property would be if such property were placed in service at the same time as such addition or improvement. Certain improvements to nonresidential real property are eligible for the additional first-year depreciation deduction if the other requirements of §168(k) are met.

Depreciation allowances for improvements made on leased property are determined under MACRS, even if said recovery period assigned to the property is longer than the term of the lease. It does not matter whether the lessor or the lessee places the leasehold improvements in service. If the leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement generally is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement

was placed in service (with exceptions for qualified restaurant property, and qualified retail improvement property.

There is an alternative depreciation system (ADS), the use of which is required for tangible property used predominantly outside the United States, certain tax-exempt property, tax-exempt bond financed property, and certain imported property covered by an Executive order. A taxpayer can also elect to use ADS for any class of property for any tax year. Under ADS, all property is depreciated using the straight line method over recovery periods which are generally equal to the class life of the property. Exceptions apply.

Act

The Act maintains the present law general MACRS recovery period of 39 and 27.5 years for nonresidential real and residential rental property.

The Act eliminates the separate definitions of qualified leasehold improvements, qualified restaurant improvements, and qualified retail improvements, and maintains a general 15-year recovery period for qualified improvement property, or 20 years under ADS. The Act uses a single-term "qualified improvement property" defined 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.

The Act also requires a real property trade or business electing out of the limitation on the deduction for interest to use ADS to depreciate any of its nonresidential real property, residential rental property, and qualified improvement property. The Act shortens the ADS recovery period for residential real property to 30 years (from 40 years).

The Act requires electing farming businesses to use the alternative depreciation system for property with a recovery period of 10 years or more. An electing farming business is one that elects out of the limitation on the deduction for interest under the Act.

Effective for property placed in service after December 31, 2017, and electing real property trade or business to taxable years beginning after December 31, 2017.

Expensing of certain costs of replanting citrus plants lost by reason of casualty [Act §13207; I.R.C. §263A] —

Current Law

Taxpayers are not required under the UNICAP rules to capitalize costs incurred due to the replanting of edible crops following loss or damage due to casualty, so long as the same type of crop lost or damaged is replanted. The exception to this requirement also applies to costs incurred by a person other than the taxpayer, if: (1) the taxpayer has more than a 50% equity interest, and (2) the other person with a minority equity interest materially participates in the business during the taxable year in which the replanting costs were incurred.

Act

The Act provides that a person other than the taxpayer may deduct replanting costs for citrus plants lost or damaged due to casualty if (1) the taxpayer has an equity interest of not less than 50% in the replanted plants and the other person has any remaining equity interest, or (2) the other person acquires all of the taxpayer's equity interest in the land.

Effective for costs paid or incurred after December 22, 2017, through 10 years after such date.

Accounting Methods

Taxable year of inclusion [Act §13221; I.R.C. §451, §481] —

Current Law

Taxpayer may defer income related to advance payments when the taxpayer receives payment before the taxpayer provides goods or services to its customer. The exceptions allow tax deferral to mirror financial accounting deferral.

To compute original issue discount (OID) and the portion of OID allocable to a period, the stated redemption price at maturity and the term must be known. Issuers of OID instruments accrue and deduct the amount of OID as interest expense in the same manner as the holder.

If a taxpayer holds a pool of credit card receivables that require interest to be paid only if the borrowers do not pay their accounts by a specified date (“grace-period interest”), the taxpayer is required to accrue interest or OID on such pool based upon a reasonable assumption regarding the timing of the payments of the accounts in the pool. Under these rules, certain amounts (other than grace period interest) related to credit card transactions, such as late-payment fees, cash-

advance fees, and interchange fees, have been determined to create OID or increase the amount of OID on the pool of credit card receivables to which the amounts relate.

Act

The Act revises the income recognition rules to provide that a taxpayer is treated as meeting the all events test with respect to an item of gross income no later than the tax year in which that item is taken into account as revenue in an applicable financial statement or other financial statement specified by the IRS. An exception applies for long-term contract income to which §460 applies.

The Act also allows taxpayers to defer the inclusion of income associated with certain advance payments to the end of the tax year following the tax year of receipt if such income also is deferred for financial statement purposes, codifying Rev. Proc. 2004-34.

An exception applies for any item of gross income for which a special method of accounting is used (other than the special methods of accounting that apply to bonds and other debt instruments under §1271-§1288). Thus, taxpayers would be required to apply the revenue recognition rules under §451 before applying the rules under §1271-§1288 (including the OID rules under §1272).

An exception applies to any item of gross income in connection with a mortgage servicing contract.

Effective for taxable years beginning after December 31, 2017. However, in the case of income from a debt instrument having original issue discount, the Act is effective for taxable years beginning after December 31, 2018, and the period for taking into account any adjustments under §481 by reason of a qualified change in method of accounting would be six years.

Small Business Reforms

Section 179 expensing [Act §13101; I.R.C. §179] —

Current Law

Businesses may immediately expense up to $500,000 (adjusted for inflation - $510,000 for 2017) of the cost of any §179 property placed in service each tax year. If the business places in service more than $2 million (adjusted for inflation - $2,030,000 for 2017) of §179 property in a tax year, then the amount available for immediate expensing is reduced by the amount by which the cost of such property exceeds $2 million (as adjusted). Further limitations on the ability to immediately expense this amount may apply based on the business's taxable income for the year.

Section 179 property under includes the following types of property, if they are acquired by purchase for use in the active conduct of a trade or business: tangible MACRS §1245 property, certain off-the-shelf computer software, qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. It generally does not include property used outside of the United States.

Act

The Act increases the amount that a taxpayer may expense under §179 from $500,000 to $1,000,000 and increases the phase-out threshold from $2,000,000 to $2,500,000.

The Act also expands the definition of §179 property to include certain depreciable tangible personal property used predominantly to furnish lodging.

The Act expands the definition of qualified real property to include investments to nonresidential real property placed in service after the date such property was first placed in service including the following: roofs, heating, ventilation, and air-conditioning property, fire protection and alarm systems, and security systems.

Effective for taxable years beginning after December 31, 2017.

Small business accounting method use of gross receipts method [Act §13102(a); I.R.C. §447, §448, §471] —

Current Law

Corporations and partnerships with corporate partners are prohibited from using the cash method of accounting unless they have average gross receipts of less than $5 million for the prior three taxable years. Certain farming entities are prohibited from using the cash method if average gross receipts exceed $1 million. Family farm corporations are permitted to use the cash method if average gross receipts do not exceed $25 million. Qualified personal service corporations are generally permitted to use the cash method regardless of gross receipts.

Act

The Act increases the $5 million average gross receipts threshold for corporations and partnerships with corporate partners that are not allowed to use the cash method of accounting to $25 million (indexed for inflation) and extends the cash method of accounting to certain farming entities, subject to the threshold amount. Qualified personal service corporations will still be permitted to use the cash method regardless of gross receipts. The requirement that such businesses satisfy the requirement for all prior years is repealed.

The Act also uses the same dollar limits for farming C corporations (and farming partnerships with C corporation partners) to use the cash method of accounting. In addition, the Act continues to allow qualified personal service corporations, partnerships without C corporation partners, S corporations, and other pass-through entities to use the cash method without regard to whether they meet the $25 million gross receipts test, so long as the use of such method clearly reflects income.

The Act provides for automatic consent for accounting method changes made by taxpayers meeting the increased average gross receipts test. Such taxpayers would be subject to adjustments under §481.

Generally effective for taxable years beginning after December 31, 2017.

Uniform capitalization of certain expenses [Act §13102(b); I.R.C. §263A] —

Current Law

Under the UNICAP rules, businesses must either include in inventory or capitalize certain direct and indirect costs related to real or tangible property, whether manufactured or acquired for resale. Businesses with less than $10 million in average gross receipts are exempt from this requirement with respect to personal property acquired for resale. There are also several industry or item specific exemptions from the UNICAP rules.

Act

Under the Act, any producer or reseller with average gross receipts of less than $25 million would be exempt from the UNICAP rules. Exemptions from the UNICAP rules which are not tied to a gross receipts test are retained.

The Act provides for automatic consent for accounting method changes made by taxpayers meeting the increased average gross receipts test. Such taxpayers are subject to adjustments under §481.

Generally effective for taxable years beginning after December 31, 2017.

Inventory accounting rules for small businesses [Act §13102(c); I.R.C. §448, §471] —

Current Law

Businesses where the production, purchase, or sale of merchandise is a material income-producing factor must account for inventories and must also use the accrual method as their overall method of accounting. Taxpayers who have average gross receipts of less than $10 million may account for inventory as materials and supplies that are not incidental and use the cash method as their overall method of accounting; corporations and partnerships with corporate partners remain limited to the $5 million average gross receipts test. Certain industries are still required to account for inventories if their average gross receipts exceed $1 million.

Act

The $25 million average gross receipts test (see above) also applies to exempt the taxpayer from the requirement to account for inventories, permitting such taxpayers to either treat inventories as materials and supplies that are not incidental or conform to the taxpayer's financial accounting treatment of inventories.

The Act provides for automatic consent for accounting method changes made by taxpayers meeting the increased average gross receipts test. Such taxpayers are subject to adjustments under §481.

Generally effective for taxable years beginning after December 31, 2017.

Gross receipts test for construction contract exception to percentage of completion method [Act §13102(d); I.R.C. §460] —

Current Law

Certain small business with long-term contracts to be completed within two years are exempt from the requirement to use the percentage-of-completion method of accounting if their average gross receipts exceed $10 million and may instead use the taxpayer favorable completed contract method or other applicable methods.

Act

The Act increases the $10 million average gross receipts exception to the requirement to use the percentage-of-completion accounting method for long-term contracts to be completed within two years to $25 million, and businesses that meet such exception would be permitted to use the completed-contract method (or any other permissible exempt contract method).

Generally effective for contracts entered into after December 31, 2017, in taxable years ending after such date.

Small business exemption from limitation on deduction of business interest [Act §13301; I.R.C. §163(j)] —

Current Law

Business interest is generally allowed as a deduction in the tax year in which the interest is paid or accrued, subject to a number of limitations. Act §13301, below, would subject every business, regardless of its form, to a disallowance of a deduction for net interest expense in excess of 30% of the business's adjusted taxable income. The net interest expense disallowance would be determined at the tax filer level—for example, at the partnership level instead of the partner level.

Act

The Act exempts small businesses with average annual gross receipts of $25 million or less for the three-tax-year period ending with the previous tax year (other than tax shelters prohibited from using the cash method of accounting) from Act §13301‘s disallowance of a deduction for net interest expense in excess of 30% of the business's adjusted taxable income.

Effective for taxable years beginning after December 31, 2017.

Business-related Exclusions, Deductions, Etc.

Limitation on losses for taxpayers other than corporations [Act §11012; I.R.C. §461] —

Current Law

The passive loss rules, which apply to individuals, estates and trusts, and closely held corporations, limit the deduction of losses from passive trade or business activities of a taxpayer. In addition, the excess farm loss rules, which apply to taxpayers other than C corporations, limit the deduction of excess farm losses of a taxpayer in certain circumstances. An excess farm loss for a tax year is the excess of the aggregate deductions attributable to farming businesses over the sum of (i) the aggregate gross income or gain attributable to farming businesses, and (ii) a threshold amount.

Act

The Act expands the limitation on excess farm losses to also apply to excess business losses of a taxpayer other than a C corporation for taxable years beginning after December 31, 2017, and before January 1, 2026. An excess business loss of a taxpayer will not be allowed as a deduction for the tax year incurred, but can be carried forward and treated as part of the taxpayer's net operating loss carryforward in subsequent tax years.

An excess business loss for a tax year is the excess of the aggregate deductions attributable to trades or businesses of the taxpayer, over the sum of (i) the aggregate gross income or gain attributable to trades or businesses of the taxpayer, and (ii) a threshold amount. The threshold amount is $500,000 for married individuals filing jointly and $250,000 for other individual taxpayers. The threshold amounts is to be indexed for inflation.

In the case of a partnership or S corporation, the limitation applies at the partner or shareholder level. For this purpose, each partner's or shareholder's share of items of income, gain, deduction, and loss of the partnership or S corporation is taken into account for the tax year of the partnership or S corporation.

Effective for taxable year beginning after December 31, 2017.

Interest [Act §13301; I.R.C. §163] —

Current Law

Business interest generally is deductible in the year in which the interest is paid or accrued.

Act

The Act limits the deduction for business interest expense to the sum of business interest income plus 30% of the adjusted taxable income of the taxpayer for the taxable year plus the floor plan financing interest of such taxpayer for such taxable year. The limitation applies on a taxpayer level. For affiliated corporations that file a consolidated return, it applies at the consolidated tax return filing level. In the case of any partnership, the limitation would applies at the partnership level. Additionally, special rules apply to the determination of adjusted taxable income of each partner of the partnership in order to prevent double counting.

For tax years beginning after December 31, 2017, and before January 1, 2022, the Act provides that adjusted taxable income is computed without regard to deductions allowable for depreciation, amortization, or depletion. Additionally, because the Act repeals §199 effective December 31, 2017, adjusted taxable income is computed without regard to such deduction.

The Act provides that any interest disallowed as a deduction may be carried forward indefinitely.

At the taxpayer's election, the limitation will not apply to real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business to be treated as a trade or business for purposes of the limitation. Additionally, the limit does not apply to certain regulated public utilities or electric cooperatives, including the furnishing or sale of (1) electrical energy, water, or sewage disposal services, (2) gas or steam through a local distribution system, or (3) transportation of gas or steam by pipeline, provided that the rates for furnishing or sale have been established or approved by a state or political subdivision thereof, by any agency or instrumentality of the United States, or by public service or public utility commission or other similar body of any state or political subdivision thereof.

The Act allows a farming business (as defined in §263A(e)(4)) to elect not to be subject to the limitation. Such electing farming business will be required to use the alternative depreciation system for property with a recovery period of 10 years or more. The Act also will not include as trades or businesses of new §199A(g)(2) specified agricultural or horticultural cooperatives that such elects to be excluded.

The Act provides an exemption for certain taxpayers that meet the $25 million gross receipts test of §448(c). This allows taxpayers with annual gross receipts that do not exceed $25 million for the three prior taxable-year period to be exempt from the limitation on interest deductibility (see further discussion above).

The Act defines floor plan financing to mean indebtedness used to finance the acquisition of motor vehicles held for sale or lease and secured by the inventory so acquired. The Act defines motor vehicle to be any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road; a boat; or farm machinery or equipment.

Effective for taxable years beginning after December 31, 2017.

Net operating loss deduction [Act §13302; I.R.C. §172] —

Current Law

A net operating loss is the amount by which a taxpayer's current-year business deductions exceed its current-year gross income. Net operating losses may not be deducted in the year generated, but may be carried back two years and carried forward 20 years.

Act

The Act limits the net operating loss deduction to 80% of taxable income . Carryovers to the succeeding tax years are adjusted to take into account this limitation.

The Act allows carryovers to be carried forward indefinitely and generally repeals the two-year carry back period, except for certain losses incurred in the trade or business of farming. Property and casualty insurance companies also continue use of the 2-year carryback and 20 year carryforward to offset 100% of taxable income.

The change to allow indefinite carryovers applies to losses arising in tax years beginning after December 31, 2017. The change to limit the NOL deduction applies to losses arising in tax years after December 31, 2017.

Like-kind exchanges of real property [Act §13303; I.R.C. §1031] —

Current Law

No gain or loss is recognized to the extent that property held for productive use in the taxpayer's trade or business, or property held for investment purposes, is exchanged for property of a like-kind that also is held for productive use in a trade or business or for investment.

Act

The Act limits like-kind exchange treatment to real property not held primarily for sale. The Act treats an interest in a partnership which has made a §761(a) election as an interest in each of the assets of the partnership and not as an interest in a partnership. The Act treats real property located in a foreign country as not like-kind to real property located in the United States.

Effective for exchanges completed after December 31, 2017, except the provision does not apply to exchanges in which the exchanged property is disposed of or the exchange property is received on or before December 31, 2017.

Contributions to capital [Act §13312; I.R.C. §118] —

Current Law

The gross income of a corporation generally does not include contributions to its capital. Contributions to aid in construction are contributions to the capital of a corporation except that contributions to aid in the construction of a regulated public utility that provides water or sewage disposal services are tax-free contributions to the capital of a corporation. Property acquired by a corporation which is not contributed by a shareholder has an adjusted basis of zero. If the contribution is money then the corporation must reduce the basis of property acquired with the contributed money within the 12-month period following the contribution, and then reduce basis of other property held by the corporation.

Act

The Act retains the general rule that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. However, the Act provides two exceptions under which the term "contribution to the capital of the taxpayer" does not include (1) any contribution in aid of construction or any other contribution as a customer or potential customer, and (2) any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such).

Generally effective for contributions made after December 22, 2017; however, an exception applies to contributions made after December 22, 2017, by a governmental entity pursuant to a master development plan approved by a governmental entity prior to such date.

Deduction for certain fines, penalties, and other amounts [Act §13306; I.R.C. §162, §6050X (new)] —

Current Law

No deduction is allowed for fines or penalties paid to a government for the violation of any law.

Act

The Act disallows deductions for any otherwise deductible amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or specified nongovernmental 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. An exception applies to any amount paid or incurred as taxes due. An exception also applies to payments that are either restitution (including remediation of property) or amounts required to come into compliance with any law that was violated or involved in the investigation or inquiry, that are identified in the court order or settlement agreement as restitution, remediation, or required to come into compliance. Any restitution for failure to pay any tax and assessed as restitution under the Internal Revenue Code is deductible only to the extent it would have been allowed as a deduction if it had been timely paid. The IRS could challenge the characterization of an amount so identified, but no deduction would be allowed unless the identification is made. Restitution or included remediation of property would not include reimbursement of government investigative or litigation costs.

These rules apply only if a government (or other entity treated in a manner similar to a government under the provision) is a complainant or investigator with respect to the violation or potential violation of any law.

Government agencies (or entities treated as such agencies) have to report to the IRS and the taxpayer the amount of each settlement agreement or order entered into if the aggregate amount required to be paid or incurred to or at the direction of the government is at least $600 (or other amount specified by the Treasury). The report has to separately identify any amounts that are for restitution or remediation of property, or correction of noncompliance, and has to be made at the time the agreement is entered into.

Effective for amounts paid or incurred after December 22, 2017, except that it does not apply to amounts paid or incurred under any binding order or agreement entered into before that date. The changes would, however, apply to amounts paid or incurred under a binding order or agreement entered into before December 22, 2017, if the order or agreement requires court approval, unless such approval was obtained before such date.

Denial of deduction for settlements subject to a nondisclosure agreement paid in connection with sexual harassment or sexual abuse [Act §13307; I.R.C. §162] —

Current Law

Taxpayers generally may deduct ordinary and necessary expenses paid or incurred in carrying on any trade or business, but several exceptions apply.

Act

The Act disallows a deduction for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if the payment is subject to a nondisclosure agreement.

Effective for amounts paid or incurred after December 22, 2017.

Local lobbying expense deduction [Act §13308; I.R.C. §162] —

Current Law

Businesses are not allowed to deduct expenses related to lobbying and political expenditures with respect to legislation and candidates for public office. An exception to this rule allows for the deduction of lobbying expenses with respect to legislation before local government bodies, including Indian tribal governments.

Act

The Act eliminates the local lobbying exception so that lobbying expenses with respect to legislation before local government bodies and Indian tribal governments would no longer be deductible.

Effective for amounts paid or incurred after December 22, 2017.

Domestic production activities deduction [Act §13305; I.R.C. §199] —

Current Law

Taxpayers may claim a deduction equal to 9 % of the lesser of the taxpayer's qualified production activities income, which is derived from property that was manufactured, produced, grown, or extracted within the United States, or the taxpayer's taxable income for the tax year.

Act

The Act repeals the domestic production activities deduction.

Effective for taxable years beginning after December 31, 2017.

Entertainment, etc expenses [Act §13304; I.R.C. §274] —

Current Law

Employers can only deduct expenses associated with entertainment, amusement, or recreational activities if they establish that the activity was directly related to the active conduct of the employer's trade or business or a facility used in connection with such activity. If an employer is entitled to deduct entertainment expenses, there generally is a 50% cap of the amount otherwise deductible. No deduction is allowed for membership dues with respect to any club organized for entertainment purposes. Gross income generally includes the value of employer-provided fringe benefits, except as discussed below. In general, a service provider includes in gross income the amount by which the fair market value of a fringe benefit exceeds the sum of the amount paid by the service provider and the amount that is specifically excluded from gross income. Certain employer-provided fringe benefits are excluded from a service provider's gross income. These include de minimis fringes, qualified transportation fringes, and meals that are provided for the convenience of the employer. Qualified transportation fringes include qualified parking, transit passes, vanpool benefits, and qualified bicycle commuting reimbursements.

Act

The Act repeals the present-law exception to the deduction disallowance for entertainment expenses that are directly related to a taxpayer's trade or business. The Act also obsoletes the 50% deduction cap.

The Act allows taxpayers to continue to deduct 50% of food and beverage expenses associated with operating their trade or business, but expands this 50% limitation to expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for de minimis fringes.

The Act disallows a deduction for (1) expenses associated with providing any qualified transportation fringe benefit to employees, as well as (2) any expenses incurred for providing transportation for commuting between an employee's residence and place of employment, except as necessary to ensure the safety of an employee.

The Act disallows an employer's deduction for expenses associated with meals provided for the convenience of the employer on the employer's business premises or provided on or near such premises through an employer-operated facility that meets certain requirements.

Effective for amounts paid or incurred after December 31, 2017. The effective date of the meals disallowance is for taxable years beginning after December 31, 2025.

Research and experimental expenditures [Act §13206; I.R.C. §174] —

Current Law

Taxpayers my elect either to deduct currently research or experimental expenditures paid or incurred in connection with a present or future trade or business or to treat such expenditures as deferred expenses and amortize these costs over a period of not less than 60 months.

Act

The Act requires specified research or experimental expenditures, including software development expenditures, to be capitalized and amortized ratably over a five-year period (15 years if attributable to research conducted outside of the United States), beginning with the midpoint of the tax year in which the research or experimental expenditures were paid or incurred.

Specified research or experimental expenditures does not include expenditures for land acquisition and improvement, the acquisition or improvement of property subject to depreciation or depletion (but the depreciation or depletion expense are considered expenditures), as well as expenditures for mineral, oil, and gas exploration. Upon retirement, abandonment, or disposition of property, any remaining basis continues to be amortized over the remaining amortization period.

The Act treats the amendments as a change in the taxpayer's method of accounting for purposes of §481, initiated by the taxpayer, and made with the consent of the Secretary.

Effective for amounts paid or incurred in taxable years beginning after December 31, 2021.

Self-created property not treated as a capital asset [Act §13314; I.R.C. §1221(a)(3)] —

Current Law

A self-created patent, invention, model or design, or secret formula or process is treated as a capital asset.

Act

The Act adds self-created patents, inventions, models or designs, or secret formulae or processes to the list of assets that are not capital assets. However, the Act preserves the election to treat musical compositions or copyrights in musical works as capital assets.

Effective for dispositions after December 31, 2017.

Banks and Financial Instruments

Deduction for FDIC premiums [Act §13531; I.R.C. §162] —

Current Law

Amounts paid by insured depository institutions pursuant to an assessment by the Federal Deposit Insurance Corporation (FDIC) to support the Deposit Insurance Fund (DIF) are currently deductible as a trade or business expense.

Act

The Act eliminates the deduction for FDIC premiums for financial institutions with consolidated assets over $50 billion. For institutions with consolidated assets of $10 billion or less, the Act continues to allow a full deduction. For assets between $10 billion and $50 billion, the Act imposes a deduction limit based on a ratio of the excess of total consolidated assets over $10 billion to $40 billion.

Effective for taxable years beginning after December 31, 2017.

Rollover of publicly traded securities gain into specialized small business investment companies [Act §13313; I.R.C. §1044] —

Current Law

Gain or loss generally is recognized on any sale, exchange, or other disposition of property. However, individuals and corporations may roll over, without recognition of income, any capital gain realized on the sale of publicly traded securities when the proceeds are used to purchase common stock or a partnership interest in a specialized small business investment corporation (SSBIC) within 60 days of the sale of the securities. The amount of gain that a taxpayer may roll over in a tax year is limited to the lesser of: (1) $50,000 ($250,000 for corporations), or (2) $500,000 ($1,000,000 for corporations) reduced by any gain previously excluded under this special rule for all preceding tax years.

Act

The Act repeals the rule permitting gains on publicly traded securities to be rolled over to an SSBIC.

Effective for sales after December 31, 2017.

Business Credits

Orphan drug credit [Act §13401; I.R.C. §45C, §280C] —

Current Law

Drug manufacturers may claim a credit (the orphan drug credit), as part of the general business credit, equal to 50% of qualified clinical testing expenses.

Act

The Act changes the orphan drug credit rate from 50% to 25%. Taxpayers can elect a reduced credit in lieu of reducing otherwise allowable deductions (similar to the research credit under §280C).

Effective for amounts paid or incurred in taxable years beginning after December 31, 2017.

Rehabilitation credit [Act §13402; I.R.C. §47] —

Current law

The rehabilitation credit is a one-time credit (either 20% or 10%) based on a fixed percentage of rehabilitation costs incurred in connection with the rehabilitation of certain real property.

Act

The Act limits the rehabilitation credit to 20% of certified rehabilitation expenditures for certified historic buildings. A taxpayer must claim the credit ratably over a five-year period beginning in the taxable year in which a qualified rehabilitated structure is placed in service. Additionally, the Act repeals the 10% credit for pre-1936 buildings.

Generally effective for amounts paid or incurred after December 31, 2017, with a transition rule for qualified rehabilitation expenditures incurred with respect to any building owned or leased by the taxpayer at all times on and after January 1, 2018, through the end of a 24-month period selected by the taxpayer (or the 60-month period selected by the taxpayer under the rule for phased rehabilitation) that begins within 180 days after enactment (December 22, 2017).

Employer credit for paid family and medical leave [Act §13403; I.R.C. §45S (new)] —

Current Law

The Code does not provide a tax benefit to employers for compensation paid to employees while on leave.

Act

The Act allows eligible employers (employers that allow all qualifying full-time employees at least two weeks annual paid family and medical leave, and allow part-time employees a commensurate amount of leave on a pro rata basis, without regard to leave paid for by a state or local government) to claim a business credit equal to 12.5% of the wages paid to qualifying employees during any period during which such employees are on family and medical leave (FMLA leave) if the payment rate under the program is 50% of the wages normally paid to an employee. The credit is increased by 0.25 percentage points (but not above 25%) for each percentage point by which the rate of payment exceeds 50%.

A qualifying employee is any employee, as defined in §3(e) of the Fair Labor Standards Act of 1938, whom the employer has employed for at least one year, and whose compensation for the preceding year was less than or equal to 60% of the compensation threshold for highly compensated employees. If an employer provides paid leave as vacation leave, personal leave, or other medical or sick leave, this paid leave would not be considered family and medical leave.

The credit is part of the general business credit.

Effective for wages paid in taxable years beginning after December 31, 2017, but the credit does not apply to wages paid in taxable years beginning after December 31, 2019.

Bond Reforms

Advance refunding bonds [Act §13532; I.R.C. §103, §149] —

Current Law

Interest on advance refunding bonds is generally not taxable for governmental bonds but is taxable for private activity bonds.

Act

The Act repeals the exclusion from gross income for interest on a bond issued to advance refund another bond.

Effective for advance refunding bonds issued after December 31, 2017.

Tax credit bonds [Act §13404; I.R.C. §54, §54A, §54B, §54C, §54D, §54E, §54F, §54AA, §6431] —

Current Law

Holders of tax credit bonds receive federal tax credits fully or partially in lieu of interest payments from the issuer, depending on the level of federal subsidy. For some of these bonds, during 2009 and 2010, issuers had the option of instead issuing taxable bonds and receiving direct payments from the federal government.

Act

The Act repeals the rules for tax credit bonds, including clean renewable energy bonds (CREBs), qualified forestry conservation bonds, new clean renewable energy bonds (New CREBs), qualified energy conservation bonds, qualified zone academy bonds, qualified school construction bonds, and Build America Bonds. Holders and issuers of the bonds would continue to receive tax credits and payments for bonds already issued, but no new bonds would be issued.

Effective for bonds issued after December 31, 2017.

Insurance

Net operating losses of life insurance companies [Act §13511; I.R.C. §172, §805, §810, §844] —

Current Law

Life insurance companies are allowed a deduction for operations loss carryovers and carrybacks, rather than the deduction for net operating losses allowed to other corporations. The operating losses of life insurance companies may be carried back up to three tax years or carried forward up to 15 tax years.

Act

The Act repeals the special carryover rules for NOLs for life insurance companies and provide that NOLs of life insurance companies conform with the general NOL carryover rules.

Effective for losses arising in taxable years beginning after December 31, 2017.

Small life insurance company deduction [Act §13512; I.R.C. §806] —

Current Law

Life insurance companies may deduct 60% of their first $3 million of life insurance-related income. The deduction is phased out for companies with income between $3 million and $15 million, and is not available at all to life insurance companies with assets of at least $500 million.

Act

The Act repeals the small life insurance company deduction.

Effective for taxable years beginning after December 31, 2017.

Adjustment for change in computing reserves [Act §13513; I.R.C. §807] —

Current Law

For life insurance companies, an adjustment in computing reserves (which is similar to a change in tax accounting method for other businesses) may be taken into account over 10 years (regardless of whether the adjustment reduces or increases taxable income).

Act

The Act repeals the special 10-year period for life insurance companies to take adjustments in computing reserves into account and provides that life insurance companies follow the general rule for accounting method changes so that an adjustment that reduces taxable income is taken into account in the tax year during which the change occurs, and an adjustment that increases taxable income is taken into account over the course of four tax years.

Effective for taxable years beginning after December 31, 2017.

Distributions to shareholders from pre-1984 policyholders surplus account [Act §13514; I.R.C. §815] —

Current Law

Under prior law, a life insurance company was subject to a three-phase taxable income computation – meaning the company was taxed on the lesser of its gain from operations or its taxable investment income (Phase I) and, if its gain from operations exceeded its taxable investment income, 50% of such excess (Phase II). Federal income tax on the other 50% was deferred and accounted for as part of a policyholder's surplus account and, subject to certain limitations, taxed only when distributed to stockholders or upon corporate dissolution (Phase III). A company had to maintain a shareholders surplus account to track whether amounts had been distributed. Distributions to shareholders were treated as being first out of the shareholders surplus account, then out of the policyholders surplus account, and finally out of other accounts.

The Deficit Reduction Act of 1984 eliminated further deferral of tax on amounts (described above) that previously would have been deferred under the three-phase system for 1984 and the subsequent years. However, companies were not taxed on previously deferred amounts unless the amounts were treated as distributed to shareholders or subtracted from the policyholders surplus account. Direct or indirect distributions to shareholders from existing policyholders surplus accounts of a stock life insurance company were subject to tax at the corporate rate.

Current law provides that any distribution to shareholders is treated as made first, out of the shareholders surplus account, then out of the policyholders surplus account, and last, out of other accounts. (Special rules applied tor distributions made after December 31, 2004, and before January 1, 2007.)

Act

The Act repeals the rule for existing pre-1984 policyholders' surplus accounts that permitted deferral of tax on the balances until distributed.

For any stock life insurance company with an existing policyholders surplus account, tax will be imposed on the balance of the account as of December 31, 2017. A life insurance company will be required to pay tax on the balance of the account ratably over the first eight years beginning after December 31, 2017. The tax imposed on a life insurance company is the tax on the sum of life insurance company taxable income for the taxable year plus 1/8 of the balance of the existing policyholders surplus account as of December 31, 2017. The company's losses cannot offset the amount of the policyholders surplus account balance subject to tax.

Effective for taxable years beginning after December 31, 2017.

Proration rules for property and casualty insurance companies [Act §13515; I.R.C. §832] —

Current Law

Property and casualty (P&C) insurance companies are required to reduce reserve deductions for losses incurred related to the receipt of exempt income by 15% of (1) the company's tax-exempt interest, (2) the deductible portion of dividends received, and (3) the increase for the tax year in the cash value of life insurance, endowment, or annuity contracts the company owns.

Act

The Act modifies the proration and discounting rules by requiring a reduction in losses equal to 5.25% divided by the applicable top corporate tax rate. For 2018, the top corporate tax rate is 21%, and the percentage reduction is 25%. The proration percentage would be automatically adjusted in future years if the top corporate rate changed.

Effective for taxable years beginning after December 31, 2017.

Discounting rules for property and casualty insurance companies [Act §13523; I.R.C. §846] —

Current Law

A property and casualty insurance company may deduct unpaid losses that are discounted using mid-term applicable federal rates and based on a loss payment pattern. Companies may elect to use their own particular historical loss payment patterns rather than industry-wide historical loss payment patterns. The loss payment pattern is determined based upon the assumption that all losses are paid (1) in general, during the accident year and the three calendar years following the accident year, or (2) in the case of lines of business relating to auto or other liability, medical malpractice, workers' compensation, multiple peril lines, international coverage, and reinsurance, during the accident year and the 10 calendar years following the accident year. For long-tail lines of business, the loss payment pattern period is extended so that the amount of losses which would have been treated as paid in the tenth year after the accident year is treated as paid in the tenth year and in each subsequent year (up to five years) in an amount equal to the amount of the losses treated as paid in the ninth year after the accident year.

Act

The Act provides that property and casualty insurance companies use the corporate bond yield curve to discount their unpaid losses to be deducted. The corporate bond yield curve means, with respect to any month, a yield curve that reflects the average, for the preceding 60-month period (not 24-month period), of monthly yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available. The present-law three-year period for discounting certain lines of business other than long-tail lines of business is not modified under the conference agreement.

The pre-Act election permitting a taxpayer to use its own (rather than an aggregate industry-experience-based) historical loss payment pattern is repealed.

Further, the Act changes the rules for the loss payment pattern so that, for all lines of business, the amount of losses that would have been treated as paid in the third year after the accident year are be treated as paid in the third year and in each subsequent year in an amount equal to the average of the amount of the losses treated as paid in the first and second years after the accident year. For lines of business relating to auto or other liability, medical malpractice, workers' compensation, multiple peril lines, international coverage and reinsurance, the amount of losses that would have been treated as paid in the tenth year after the accident year are treated as paid in the tenth year and in each subsequent year in an amount equal to the average of the amount of the losses treated as paid in the seventh, eighth, and ninth years after the accident year. The pre-Act 10-year period for certain long tail lines of business is extended for a maximum of 14 more years.

Effective for taxable years beginning after December 31, 2017. The Act provides a transition rule for the first tax year beginning after 2018 to spread adjustments related to pre-effective date losses and expenses over the first tax year beginning after 2017 and the succeeding seven tax years.

Special estimated tax payments [Act §13516; I.R.C. §847] —

Current Law

Insurance companies may elect to claim a deduction for the difference between the amount of reserves computed on a discounted basis and the amount computed on an undiscounted basis, however then must make a special estimated tax payment equal to the tax benefit attributable to the deduction. In addition, the deductions are added to a special loss discount account and, as losses are paid in future years, amounts are subtracted from the account and made subject to tax. Amounts added to the special loss discount account are automatically subtracted from the account and made subject to tax if they have not already been subtracted after 15 years.

Act

The Act repeals the §847 elective deduction that permits insurance companies to elect to claim a deduction for the difference between the amount of reserves computed on a discounted basis and the amount computed on an undiscounted basis, and repeals the related estimated tax payment rules.

The entire balance of an existing account will be included in the taxpayer's income for the first taxable year beginning after 2017, and the entire amount of existing special estimated tax payments will be applied against the amount of additional tax attributable to this inclusion. Excess special estimated tax payments will be treated as estimated tax payments under §6655.

Effective for taxable years beginning after December 31, 2017.

Computation of life insurance tax reserves [Act §13517; I.R.C. §807] —

Current Law

Reserve items consist of life insurance reserves, unearned premiums and unpaid losses, certain annuity and insurance contract satisfaction amounts, certain dividend accumulations, advance premiums and premium deposit fund liabilities, reserve and unearned premium reserve on retiree medical policies, and certain reasonable contingency reserves under group term life or health insurance.

Special rules apply with respect to the interest rate used in the computation of annuity and insurance contract satisfaction amounts and to the determination of unpaid losses.

For any tax year, the net decreases in reserves that must be included in life insurance gross income equals the opening balance for the tax year of certain reserve items reduced by the net closing balance for the tax year of those reserve items. The net closing balance of reserve items equals the closing balance of those reserve items reduced by the policyholders' share of tax-exempt interest and the amount of the policyholders' share of the increase for the tax year in policy cash values of life insurance policies and annuity and endowment contracts to which §264(f) applies.

For variable contracts, as for fixed contracts, a life insurance company determines its income or deduction from a change in reserves using the amounts of its life insurance reserves determined under §807.

Act

The Act amends the appropriate rate of interest to be the highest rate or rates permitted to be used to discount the obligations by the National Association of Insurance Commissioners as of the date the reserve is determined.

The amount of life insurance reserves for any contract other than a variable contract would be the greater of (1) net surrender value of the contract, or (2) 92.81% of the reserve determined by using the tax reserve method applicable to the contract.

The amount of the life insurance reserves for a variable contract would be the greater of (1) the net surrender value of the contract, or (2) the portion of the reserve that is separately accounted for under §817 (dealing with the treatment of variable contracts), plus 92.81% of the excess (if any) of the reserve determined by using the tax reserve method applicable to the contract over the greater of the net surrender value of the contract or the portion of the reserve that is separately accounted for under §817.

The amount of life insurance reserves may not exceed the annual statement reserves.

The Act eliminates the provisions regarding the treatment of substandard risks and the determination of the issuance date for group contracts.

The Act also imposes reporting requirements (in a time and a manner prescribed by the Secretary) to report the opening balance and closing balance of reserves and effect as of the date the reserve is determined.

Effective for tax years beginning after December 31, 2017 with a transition for tax years beginning after December 31, 2017.

Modification of rules for life insurance proration for purposes of determining the dividends received deduction [Act §13518; I.R.C. §812] —

Current Law

For insurance companies, deductions are limited or disallowed in certain circumstances if they are related to the receipt of exempt income. Under so-called "proration" rules, life insurance companies are required to reduce deductions, including dividends-received deductions and reserve deductions, to account for the fact that a portion of dividends and tax-exempt interest received is used to fund tax-deductible reserves for the companies' obligations to policyholders. This portion is determined by a formula that computes the respective shares of net investment income that belong to the company and to the policyholders. Current law is unclear as to what methods companies may use to compute the company share.

Act

The Act provides that, for purposes of §805(a)(4), the term "company's share" mean 70%, with respect to any tax year beginning after December 31, 2017. The Act also provides that, for purposes of §807, the term "policy holder's share" means 30%, with respect to any tax year beginning after December 31, 2017.

Effective for taxable years beginning after December 31, 2017.

Policy acquisition expenses [Act §13519; I.R.C. §848] —

Current Law

Life insurance company expenses associated with earning a stream of premium income generally are required to be spread over 10 years. Those expenses are calculated using a simplified method that reflects expense ratios for three broad categories of insurance contracts and are the lesser of a specified percentage of the net premiums received on each of the company's three categories of insurance contracts, or the company's general deductions. For annuity contracts, the specified percentage is 1.75%; for group life insurance contracts, it is 2.05%; and for all other specified insurance contracts, it is 7.7%.

Act

The Act extends the amortization period for specified policy acquisition expenses to the 180-month period beginning with the first month in the second half of the tax year. The Act also modifies the specific percentage of net premiums deductible for certain insurance contracts: 2.09% for annuity contracts, 2.45% for group life insurance contracts, and 9.2% for all other specified insurance contracts. The Act additionally adds a special transition rule retaining the 120-month period for specified policy acquisition expenses first required to be capitalized in a tax year beginning before January 1, 2018.

Effective for net premiums for taxable years beginning after December 31, 2017.

Tax reporting for life settlement transactions, clarification of tax basis of life insurance contracts, and exception to transfer for valuable consideration rules [Act §13520, §13521, §13522; I.R.C. §101, §1016, §6047, §6050Y (new)] —

Current Law

An exclusion from federal income tax exists for amounts received under a life insurance contract paid by reason of the death of the insured.

Transfer for value rules provided that if a life insurance contract is sold or otherwise transferred for valuable consideration, the excludable amount paid by reason of the death of the insured is generally limited – the exclusion may not exceed the sum of the actual value of the consideration, and the premiums or other amounts subsequently paid by the transferee of the contract.

There are exceptions to this limitation. For instance, the limitation does not apply if the transferee's basis in the contract is determined in whole, or in part by reference to the transferor's basis in the contract, or if the transfer is to the insured, to a partner of the insured, to a partnership in which the insured is partner, or to a corporation in which the insured is a shareholder of officer.

Under IRS guidance, income recognized under §72(e) on surrender (to the life insurance company) of a life insurance contract with cash value is ordinary income. If a cash value life insurance contract is sold, the insured's basis is reduced by the cost of insurance, and the gain on the sale of the contract is ordinary income to the extent of the amount that would be recognized as ordinary income if the contract were surrendered, and any excess is long-term gain. Additionally, gain on the sale of a term life insurance contract is considered long-term capital gain.

IRS guidance also provides that under the transfer for value rules, a portion of the death benefit received by a buyer of a life insurance contract on the death of the insured in includable as ordinary income. The portion is the excess of the death benefit over the consideration and other amounts paid for the contract. Upon the sale of the contract, the gain is long-term capital gain, and the basis of the contract is not reduced by the cost of the insurance.

Act

In general, the Act imposes reporting requirements on the purchase of an existing life insurance contract in a reportable policy sale. The Act additionally imposes reporting requirements on the payor in the case of the payment of reportable death benefits.

Reporting Requirements:

Any person who acquires a life insurance contract, or an interest in a life insurance contract, in a reportable policy sale during the taxable year, will be subject to new reporting requirements. A reportable policy sale would include the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured. Indirect acquisitions would include the acquisition of an interest in a partnership, trust, or other entity holding an interest in the life insurance contract.

New reporting requirements require that the buyer report (1) the buyer's name, address, and taxpayer identification number (TIN), (2) the name, address and TIN of each recipient of payment in the sale, (3) the date of the sale, and (4) the amount of each payment to the IRS, the insurance company that issued the contract, and to the seller. The buyer will not have to report the amount of the payment or payments for the purchase of the contract to any issuer of life insurance contracts.

Upon receipt of the buyer's report, or on any notice of the transfer of a life insurance contract to a foreign person, the issuer will have to report to the IRS and the seller, the basis of the contract (§72(e)(6)), the name, address, and TIN of the seller or transferor to a foreign person, and the policy number of the contract. Notice of the transfer to a foreign person will be intended to include any sort of notice, including information provided for nontax purposes such as change of address notices for purposes of sending statements or for other purposes, or information relating to loans, premium, or death benefits with respect to the contract.

If a reportable death benefit was paid under a life insurance contract, the payor insurance company will be required to report the gross amount of the payment, the payee's TIN, and the payor's estimate of the buyer's basis in the contract. Any amount paid by reason of the death of the insured under a life insurance contract that has been transferred in a reportable policy sale will be considered a reportable death benefit. For the purposes of these reporting requirements, payment means the amount of cash and the fair market value of any consideration transferred in a reportable policy sale.

Effective for reportable policy sales occurring after December 31, 2017, and reportable death benefits paid after December 31, 2017.

Determination of Basis:

The Act provides that no adjustment be made for mortality, expense, or other reasonable charges incurred under the contract in determining the basis of a life insurance or annuity contract.

Effective for transactions entered into after August 25, 2009.

Scope of Transfer for Value Rules:

The Act removes the current exceptions to the transfer for value rules in the case of a transfer of a life insurance contract, or any interest in a life insurance contract in a reportable policy sale. Accordingly, some portion of the death benefit could be included in income.

Effective for transfers occurring after December 31, 2017.

Compensation

Excessive employee remuneration [Act §13601; I.R.C. §162(m)] —

Current Law

Generally, a deduction for compensation paid or accrued with respect to a "covered employee" of a publicly traded corporation is capped at $1 million per year. The deduction limitation does not apply to commissions or performance-based remuneration (including stock options).

For purposes of the deduction limitation, a covered employee is defined by the IRS to include the principal executive officer (PEO) and the three highest compensated officers (other than the PEO) as of the close of the tax year. The current IRS definition does not necessarily include the chief financial officer (CFO). However, the SEC, for securities law purposes, currently defines a "covered employee" to include the chief executive officer (CEO), the CFO, and the three highest-paid employees, other than the CEO and CFO, who were serving as executive officers at the end of the last completed fiscal year.

Act

Under the Act, the $1 million yearly limit on the deduction for compensation with respect to a covered employee of a publicly traded corporation is modified to repeal the exceptions for commissions and performance-based compensation. "Covered employees" now include the CEO, CFO and the three highest paid employees. Once an employee qualifies as a covered employee, the deduction limitation applies to that person so long as the corporation pays remuneration to that person (or to any beneficiaries).

The Act further requires that individuals who are deemed to be covered employees for taxable years beginning after December 31, 2016, continues to be treated as covered employees for all future years, even where they are no longer employed by the corporation. The Act looks at who is a covered employee at any time of the year instead of just at the end of the year.

The Act extends the applicability of §162(m) to include all domestic publicly traded corporations and all foreign companies publicly traded through American depository receipts.

Generally applicable to tax years beginning after December 31. 2017. A transition rule applies so that no changes take effect with respect to an existing written binding contract in effect on November 2, 2017, that is not modified in any material respect on or after such date. Any contract that is entered into on or before November 2, 2017 and that is renewed after such date is treated as a new contract entered into on the day the renewal takes effect. A contract that is terminable or cancelable unconditionally at will by either party to the contract without the consent of the other, or by both parties to the contract, is treated as a new contract entered into on the date any such termination or cancellation, if made, is effective. However, a contract is not treated as so terminable or cancelable if it can be terminated or cancelled only by terminating the employment relationship of the covered employee.

Qualified equity grants [Act §13603; I.R.C. §83, §3402, §6652] —

Current Law

No provision.

Act

The Act provides tax benefits to employees of certain start-up companies under a new, proposed §83(i). Generally, an employee will be able to make a special election with respect to qualified stock transferred to them (called qualified equity grants), so that no amount will be included in income for the first taxable year in which the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. Income taxation will be deferred by the employee until the earlier of (a) five years, or (b) the occurrence of a specified event, such as the stock of the company being readily tradable on an established securities market, or a revocation of the election. A written plan will have to provide that at least 80% of the employees of the company will be granted stock options or RSUs with the same rights and privileges. The 80% eligibility requirement is met only if affected employees (new hires or existing employees) are either granted stock options or restricted stock units for that year, and not a combination of both. Certain notice requirements apply. A penaltyexists for failure to provide notice of the tax consequences.

Where an inclusion deferral election is made with respect to an incentive stock option (including one under an employee stock purchase plan), the Act provides that such option is treated as a nonqualified stock option for FICA purposes. Excluded employees who are not considered qualified individuals able to make a special election include individuals who first become a 1% owner or one of the four highest compensated officers in a taxable year, or who fell into such a classification in any of the 10 preceding taxable years. The Act also provides that receipt of qualified stock under §83(i) is not treated as a nonqualified deferred compensation plan for purposes of §409A.

The Act clarifies that §83(b) elections may not be made with respect to restricted stock units. This change prevents recipients from accelerating the taxable event to the time of the transfer itself in order to attempt to limit the amount of ordinary income that would not be recognized in acquiring and later selling the restricted stock units.

The Act provides that the provisions governing qualified equity grants apply to stock attributable to options exercised or RSUs settled after December 31, 2017. Under a transition rule, until the IRS issues regulations or other guidance implementing the 80% rule and employer notice requirements under the provision, a corporation will be treated as complying with those requirements if it complies with a reasonable good faith interpretation. The penalty for a failure to provide the required notice applies to failures after December 31, 2017.

Excise tax rate for stock compensation of insiders in expatriated corporations [Act §13604; I.R.C. §4985] —

Current Law

If a shareholder recognizes gain on a transaction described in §7874 (and even if the resulting entity is treated as a foreign corporation), then any disqualified individuals will be subject to a 15% excise tax on the value of specified stock compensation (including stock options and stock-linked compensation) held with respect to the former U.S.-incorporated entity.

Act

The Act increases the rate of the excise tax under §4985 to 20%.

Effective for corporations first becoming expatriated corporations (as defined in §4985) after December 22, 2017.

TAXATION OF FOREIGN INCOME AND FOREIGN PERSONS

Establishment of Participation Exemption System for Taxation of Foreign Income

100% deduction for foreign-source portion of dividends & repatriation “participation exemption system” for taxation of foreign income [Act §14101; I.R.C. §245A (new), §246(c), §904(b)(5)] —

Current Law

U.S. citizens, resident individuals, and U.S. corporations are subject to U.S. tax on worldwide income. U.S. shareholders of foreign corporations are generally not taxed on the income earned by the foreign corporation until the income is distributed as a dividend to the U.S. shareholders. however, subpart F of subchapter N of the Code provides an anti-deferral regime that taxes certain U.S. shareholders of controlled foreign corporations on their pro rata share of the controlled foreign corporation's current year's earnings and profits, whether or not the earnings and profits are actually distributed as dividends. Subpart F also includes a provision that prevents amounts that have been included in the gross income of U.S. shareholders as subpart F income from being taxed again when actually distributed.

Act

The Act provides a 100% deduction for the foreign-source portion of any dividend received by a domestic corporation that is a U.S. shareholder of a specified 10% owned foreign corporation. Thus, although the anti-deferral regime of subpart F was left intact, if the foreign corporation pays a dividend, the foreign-source portion of that dividend will essentially be exempt from U.S. tax. The act also provides conforming amendments, including a disallowance of any foreign tax credit (or deduction for foreign taxes) on foreign taxes paid on the foreign-source portion of the dividend.

The Act amends §246(c) to require a one-year holding period for stock in a specified 10% owned foreign corporation during which period the foreign corporation must qualify as a specified 10% owned foreign corporation and the domestic corporation must qualify as a U.S. shareholder.

The Act also adds a new provision to the foreign tax credit limitation rules that in calculating the foreign tax credit limitation, domestic corporations that are U.S. shareholders of specified 10% owned foreign corporations the foreign-source portion of the §245A must disregard the foreign-source portion of dividends for which the deduction under §245A is allowed as well as any deductions allocated or apportioned to such income.

The provision and amendments are effective for distributions (and deductions in the case of the foreign tax credit limitation calculation) made after December 31, 2017.

Special rules relating to sales or transfers involving specified 10% owned foreign corporations [Act §14102; I.R.C. §91 (new), §367, §961, §964, §1248] —

Current Law

Section 961 provides guidance with respect to basis adjustments to stock in CFCs and other property.

Under §1248(a), if a U.S. person sells or exchanges stock in a foreign corporation and that person was a 10% U.S. shareholder at any time during the five-year period ending on the date of the sale or exchange when the foreign corporation was a CFC, then the gain recognized on the sale or exchange of the stock will be included in the gross income of the U.S. person as a dividend.

Section 1016 requires that proper adjustments must be made in respect of the property, including with respect to §1059, which requires corporate shareholders to reduce basis in stock by the nontaxed portion of extraordinary dividends.

Section 964(e) provides that if a CFC recognizes gain on the sale or exchange of stock in any other foreign corporation the gain will be treated as a dividend and included in the gross income of the CFC to the same extent that it would have been under §1248(a) if the CFC were a U.S. person.

Section 367(a) provides that if a U.S. person transfers property to a foreign corporation in connection with certain nonrecognition transactions, the foreign corporation will not be treated as a corporation for purposes of determining gain recognition. Section 367(a)(3) provides exceptions to the general rule for transfers of property used in the active conduct of a trade or business; however, the exception does not apply to gain realized on the transfer of assets of a foreign branch of a U.S. person to foreign corporation to the extent that the foreign branch has previously deducted losses. §367(a)(3)(C).

Act

The Act added several provisions to the Code to ensure coordination between the new 100% dividend received deduction for the foreign-source portion dividends received by corporate U.S. shareholders of specified 10% owned foreign corporations (§245A) with existing rules for stock sales, basis adjustments, and the sale by a CFC of a lower tier CFC. The Act also added rules regarding the transfer of branch losses to a specified 10% foreign corporation and repealed the active trade or business exception under §367(a).

Sales of stock by U.S. persons: The Act added new subparagraph (j) to §1248, which provides that in the case of the sale or exchange by a domestic corporation of stock in a foreign corporation held

for one year or more, any amount received by the domestic corporation that is treated as a dividend under §1248 will also be treated as a dividend for purposes of §245A.

Basis reductions: The Act also added new §961(d), which provides that, solely for purposes of determining a loss, a corporate U.S. shareholder's basis in the stock of a specified 10% owned foreign corporation must be reduced by an amount equal to the dividend received deduction allowable under §245A in the taxable year of the corporate U.S. shareholder. Section 961(d) coordinates with the exclusion provision in §1059 so that if the stock basis has already been reduced under §1059, 961(d) does not require an additional basis reduction.

Sale by a CFC of a lower tier CFC: The Act added §964(e)(4), which provides that if an amount is treated as a dividend under §964(e)(1) because of a sale or exchange by a CFC of stock in another foreign corporation held for a year or more, then (i) the foreign-source portion of the dividend will be treated as subpart F income of the selling CFC for purposes of §951(a)(1)(A), (ii) a U.S. shareholder of the selling CFC must include its pro rata share of that subpart F income in gross income for its taxable year, and (iii) the amount included in subpart F income of the U.S. shareholder would be eligible for the deduction under new §245A in the same manner as if the subpart F income were a dividend received by the corporate U.S. shareholder from the selling CFC. The provisions applies to sales or exchanges that occur after December 31, 2017.

Inclusion of transferred loss amounts in certain asset transfers:

The Act also added §91, which provides that in the case of a domestic corporation that transfers substantially all of the assets of a foreign branch (within the meaning of §367(a)(3)(C), as in effect before the date of enactment of the Act, i.e., assets with previously deducted losses) to a specified 10% owned foreign corporation with respect to which the domestic corporation is a U.S. shareholder after the transfer, the domestic corporation must include an amount equal to the transferred loss amount in gross income, subject to certain limitations. Section 91 treats the amounts recognized under this provision as U.S. source and provides rules for basis adjustment when inclusions are recognized. Section 91 applies to transfers that occur after December 31, 2017, but includes a transition rule.

The Act repeals the active trade or business exception under §367 by striking §367(a)(3).

Treatment of deferred foreign income upon transition to "participation exemption system" of taxation [Act §14103; I.R.C. §965, §7874] —

Current Law

Section 965 provides a one-time deduction of 85% for certain dividends received by a U.S. corporate shareholder from its CFCs. The U.S. shareholder had to elect the deduction and the amount eligible for the temporary deduction was subject to several limitations and was accompanied by a proportional disallowance of the foreign tax credit with respect to the dividends for which the deduction was allowed. The amount of dividends eligible for the 85% deduction could not exceed the amount by which the cash dividends exceeded the taxpayer's average repatriation level calculated for a three-year base period preceding the year of the deduction. A separate limitation capped the eligible dividends to the greater of $500 million or the amount identified on the taxpayer's recent audited financial statements as earnings invested indefinitely outside the United States. Increases in related-party indebtedness in the year further limited the availability of the deduction. The dividends were required to be invested in the United States in accordance with a domestic reinvestment plan approved by the taxpayer's senior management and board of directors.

Since 2004 there have been additional proposals to use estimated tax collections from a proposed one-time tax on untaxed foreign earnings under a reduced tax rate as a means of long-term funding for the Highway Trust Fund. The proposals have varied with respect to whether tax should be applied to certain corporation shareholder or all shareholders, whether the one-time tax should be mandatory or voluntary, and whether the tax should be applied as a stand-alone provision or as part of broad tax reform.

Act

The Act amends §965 to require a deferred foreign income corporation to increase its subpart F income for the last taxable year that began before January 1, 2018 by the greater of the accumulated post-1986 deferred foreign income of such corporation as of November 2, 2017 or the accumulated post-1986 deferred foreign income of such corporation determined as of December 31, 2017. A "deferred foreign income corporation" is defined "with respect to any United States shareholder" as "any specified foreign corporation of such United States shareholder which has accumulated post-1986 deferred foreign income..." A specified foreign corporation is defined as any CFC and any foreign corporation with respect to which on or more domestic corporations is a U.S. shareholder exclusive of passive foreign investment companies (PFICs) that are not also CFCs.

The Act requires U.S. shareholders to include in gross income their pro rata share of the increased subpart F income, but the amended §965(b) does allow U.S. shareholders to reduce amounts included in gross income by deficits in earnings and profits from other specified foreign

corporations by netting earnings and profits among specified foreign corporations if a U.S. shareholder has interests in more than one specified foreign corporation.

Section 965 as amended by the Act also imposes two different tax rates on the net subpart F inclusions of U.S. shareholders determined by the category of deferred income — cash or other assets. The rates are reached by means of deductions applied to the income inclusions designed to reduce the income inclusion to a net amount subject to the respective tax rate, 15.5% for cash and 8% for non-cash assets.

Section 965 includes an election for taxpayers to amortize the inclusion of accumulated post-1986 deferred income over eight years; §965 also includes an election not to apply the net operating loss deduction.

Section 965 disallows the direct foreign tax credit for the applicable percentage of any taxes paid or accrued with respect to any amount for which a deduction is allowed under this section.

Section 965 also includes special rules for S corporation shareholders, including specific reporting requirements; as well as special rules for U.S. shareholders that are real estate investment trusts (REITs).

Section 965 extends the limitation on assessments to six years for the net tax liability under this section, and provides rules for recapture in the event a U.S. shareholder is allowed the deduction

Section 965 is effective for taxable years beginning after December 31, 2017.

Modifications Related to Foreign Tax Credit System

Repeal of indirect foreign tax credits; determination of deemed foreign tax credit on current-year basis [Act §14301; I.R.C. §78, §902, §960] —

Current Law

Foreign-source income earned by a foreign subsidiary of a U.S. corporation generally is not subject to U.S. tax until the income is distributed as a dividend to the U.S. parent corporation. Taxpayers are allowed foreign tax credit or a deduction for foreign income taxes paid on the income out of which the dividend is paid, but generally only when the foreign earnings are distributed to the U.S. parent or otherwise subject to U.S. taxation. The foreign tax credit generally is available to offset, in whole or in part, the U.S. tax owed on foreign-source income.

Generally, a U.S. shareholder is subject to U.S. tax on subpart F income of its CFCs, even if the income is not repatriated. A separate foreign tax credit is available to U.S. shareholders for foreign taxes paid on the subpart F income.

Act

The Act repealed §902, the indirect foreign tax credit for U.S. corporations owning 10% or more of a foreign corporation. The Act also includes amendments that disallow the foreign tax credit or a deduction for foreign taxes paid on amounts that are eligible for the allowable 100% dividend received deduction under §245A or the deduction under §965. These provisions are discussed with the respective deduction provisions.

The Act also amends §960 regarding the deemed paid foreign tax credit available to U.S. shareholders of CFCs to require that it be computed on a current year basis.

The repeal of the indirect foreign tax credit and amendment to §960 are effective for taxable year beginning after December 31, 2017.

The Act also amends the gross up rules under §78, as a conforming amendment, to ensure it coordinates with the amendment §960. The Act amends the foreign tax credit limitation provisions under §904 by adding a new limitation basket for foreign branch income and a new election for taxpayers to increase the percentage of domestic taxable income to be offset by overall domestic loss treated as foreign source.

Source of inventory sales income [Act §14303; I.R.C. §863] —

Current Law

Income from the sale or exchange of inventory property is sourced on the basis of sales and production activities, as provided by regulation. Under Reg. §1.863-3(b)(1), 50% of such income is treated as attributable to production activity and is generally sourced where the production assets are located, while the remaining 50% of the income is attributable to sales activity and is sourced where the rights, title, and interest of the seller are transferred to the buyer.

Act

The Act provides that income from the sale or exchange of inventory property is sourced solely on the basis of the production activities with respect to that property, instead of being sourced on the basis of sales and production activities.

Effective for taxable years beginning after December 31, 2017.

Separate foreign tax credit limitation basket for foreign branch income [Act §14302; I.R.C. §904] —

Current Law

U.S. owners of foreign branches are subject to U.S. tax on income earned by the foreign branch, and may receive a foreign tax credit for taxes paid to a foreign country on income earned by that branch. However, U.S. owners are not required to include income earned by the foreign branch in a separate category, i.e., a foreign tax credit limitation basket, for purposes of calculating the foreign tax credit.

Act

The Act requires foreign branch income to be allocated to a specific foreign tax credit limitation basket. Foreign branch income is defined as the business profits of a U.S. person that are attributable to at least one qualified business unit (QBU) in one or more foreign countries. The Act specifies that the business profits of a QBU do not include passive category income. However, the Act states that other rules relating to the business profits of a QBU will be established by the Secretary of the Treasury.

Effective for taxable years beginning after December 31, 2017.

Election to increase percentage of domestic taxable income offset by overall domestic loss treated as foreign source [Act §14304; I.R.C. §904] —

Current Law

For taxable years beginning prior to January 1, 2018, if an overall domestic loss (ODL) offset foreign-source income, then in later years, a portion of the taxpayer's U.S.-source taxable income is recharacterized as foreign-source income for purposes of computing the foreign tax credit. The portion of the taxpayer's U.S.-source income for years succeeding the ODL is the lesser of the amount of the loss (to the extent not used in prior taxable years) or 50% of the taxpayer's U.S.-source income.

Act

The Act provides an election to increase the percentage of taxable income treated as foreign source by allowing that if any "pre-2018 unused overall domestic loss" is taken into account for any "applicable taxable year," the taxpayer may elect to have §904(g)(1)(B) apply to the loss at a percentage greater than 50%, but not greater than 100%. The term "pre-2018 unused overall domestic loss" means any ODL that arises in a qualified taxable year beginning before January 1, 2018, that has not been used under §904(g)(1) for any taxable year beginning before January 1, 2018. "Applicable taxable year" is defined as taxable years beginning after December 31, 2017, and before January 1, 2028.

Effective for taxable years beginning after December 31, 2017.

Modification of Subpart F Provisions

Qualified investments [Act §14212; I.R.C. §955] —

Current Law

Foreign shipping income earned between 1976 and 1986 was not subject to current U.S. tax under subpart F if the income was reinvested in certain qualified shipping investments, however, net decreases in qualified shipping investments were subject to inclusion in subpart F income.

Act

The Act repeals §955 which provides definitions of terms related to the inclusion in gross income of a U.S. shareholder's pro rata share of the CFC's previously excluded subpart F income withdrawn from foreign base company shipping operations under §951(a)(1)(A)(iii). Congress deleted shipping income from foreign base company income in the American Jobs Creation Act of 2004, but did not repeal §951(a)(1)(A)(iii) or §955 at that time, apparently to account for investments remaining in shipping operations that would be withdrawn in future years. Congress has apparently decided that very little remains invested in qualified shipping operations as defined in §955. Conforming amendments streamline §951(a)(1)(A) by deleting not only the reference to investments in shipping operations in (iii), but also the reference to pre-1975 investments in less developed countries in (ii) that were also includible in subpart F income when withdrawn.

Effective for taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

Foreign base company income [Act §14211; I.R.C. §954(a), §954(c)(6)] —

Current Law

Foreign oil related income (FORI) is included as a category of foreign base company income (FBCI) and therefore U.S. shareholders of a CFC must include (FORI) in gross income to the extent it is included in the U.S. shareholder's pro rata share of subpart F income, whether or not the CFC makes an actual distribution.

Act

The Act repeals FORI as a category of FBCI.

Effective for taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

Attribution from foreign shareholders [Act §14213; I.R.C. §958(b)(4), §6038] —

Current Law

Section 958(b)(4) prevents the attribution of stock ownership from a foreign person to a U.S. person.

Act

The Act amends §958(b) to allow attribution from foreign persons to U.S. persons.

Immediate CFC status [Act §14215; I.R.C. §951(a)(1)] —

Current Law

Section 951(a)(1) requires that foreign corporation be a controlled foreign corporation (CFC) for an uninterrupted period of 30 days or more before it is classified as a CFC for tax purposes.

Act

The Act amends §951(a)(1) by removing this requirement.

Effective for taxable years beginning after December 31, 2017, and to taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

Modification of definition of United States shareholder [Act §14214; I.R.C. §951(b)] —

Current Law

Section 951(b) defines a U.S. shareholder as a U.S. person who owns directly, indirectly, or constructively, 10% or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation.

Act

The Act expands the definition of U.S. shareholder to include a U.S. person who owns directly, indirectly, or constructively, 10% or more of the total value of shares of all classes of stock of the foreign corporation.

Effective for the last taxable year of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

Rules Related to Passive and Mobile Income: Taxation of Foreign-Derived Intangible Income and Global Intangible Low-Taxed Income

Global intangible low-taxed income (GILTI) [Act §14201; I.R.C §951A (new)] —

Current Law

U.S. citizens, resident individuals and U.S. corporations are generally subject to U.S. tax on worldwide income. Generally, foreign corporations are not subject to tax on income earned in an active foreign trade or business and U.S. shareholders of foreign corporations are not subject to tax on the earnings of such foreign corporations until the income is distributed to the shareholders as dividends. However, a U.S. shareholder of a controlled foreign corporation (CFC) must include in gross income its pro rata share of the CFC's subpart F income without regard to whether the income is distributed to the shareholders. Under current transfer pricing rules, however, if a CFC owns important assets, undertakes key functions, or bears significant risks in a foreign jurisdiction, that CFC is treated as earning more than a routine profit, often resulting in substantial profits being generated at the CFC level. Allocating profits in this manner does not trigger taxation under the subpart F rules; thus, U.S. tax on those profits is deferred until they are distributed to U.S. shareholders.

Act

The Act added new §951A, which requires a U.S. shareholder of any CFC to include in gross income for a taxable year its "global intangible low-taxed income" (GILTI) for the taxable year. GILTI is determined annually with respect to each U.S. shareholder as the excess (if any) of shareholder's "net CFC tested income" for the year over the shareholder's "net deemed tangible income return" for the year.

Net deemed tangible income return is the excess of 10% of the aggregate of a shareholder's pro rata share of the "qualified business asset investment" of each CFC with respect to which the shareholder is a U.S. shareholder in that taxable year over the amount of interest expense taken into account under §951A(c)(2)(A)(ii) in determining the shareholder's net CFC tested income for the taxable year to the extent the interest income attributable to such expense is not taken into account in determining the shareholder's net CFC tested income.

Net CFC tested income is the excess (if any) of the aggregate of a shareholder's pro rata share of the tested income of each CFC with respect to which the shareholder is a U.S. shareholder for that taxable year of the U.S. shareholder (determined for each taxable year of the CFC that ends in or with such taxable year the U.S. shareholder) over the aggregate of the shareholder's pro rata share of the tested loss of each CFC with respect to which the shareholder is a U.S. shareholder of that taxable year of the U.S. shareholder (determined for each taxable year of the CFC that ends in or with the taxable year of the U.S. shareholder).

A qualified business asset investment is, with respect to any CFC for any taxable year, the average of that CFC's average adjusted bases as of the close of each quarter of that taxable year in specified tangible property used in a trade or business of the CFC and of a type with respect to which a depreciation deduction is allowable under §167. Specified tangible property is any tangible property used in the production of tested income. However, property that is used both in the production of tested income and non-tested income will only be treated as specified tangible property in the same proportion that the gross tested income produced with respect to such property bears to the total gross income produced with respect to such property. The rules regarding qualified business asset investments include special provisions regarding the determination of adjusted basis and rules applicable to partnership property.

New §951A includes specific guidance regarding the determination of pro rata shares for purposes of §951A and states that GILT included in gross income will be treated as amounts included under §951(a)(1)(A) for purposes of applying other provisions of the Code except as otherwise provided by the Secretary.

Effective for taxable years of CFCs beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

Deduction for foreign-derived intangible income and global intangible low-taxed income [Act §14202; I.R.C. §250 (new)] —

Current Law

U.S. corporations are generally subject to U.S. taxation on worldwide income and generally may deduct all of their interest expense. Non-U.S. corporations are generally not subject to U.S. tax on non-U.S. income. A U.S. shareholder of a foreign corporation is not subject to tax on the earnings of a foreign corporation unless the foreign corporation distributes the earnings as a dividend, however, if the foreign corporation is a controlled foreign corporation (CFC) the U.S. shareholder may have to include its pro rata share of current earnings and profits of the CFC in gross income currently under subpart F of subchapter N of the Code. If a domestic corporation capitalizes a foreign subsidiary with debt, the earnings from the foreign subsidiary will be foreign-source dividend income eligible for an 85% dividend received deduction under former §965 and the domestic corporation will receive a deduction against U.S. source income for the interest expense. If an alternative structure is used so that a foreign affiliate issues the debt to the U.S. entity, the U.S. entity will still receive an deduction against U.S.-source income for the interest expense paid to the foreign affiliate, but the payment to the foreign affiliate is generally subject to a statutory 30% withholding tax under §881. This rate is often reduced or even eliminated in U.S. income tax treaties, however, and the foreign affiliate could be subject to little or no tax on the interest income, reducing the global effective tax rate of the affiliated group. Consequently, U.S. corporations can erode the U.S. tax base by deducting interest paid on related-party debt (even when the amount of interest expense is legitimately arm's length) without paying U.S. tax on the corresponding income.

Act

The Act adds a new provision, §250, to the Code which allows a domestic corporation a deduction equal to the sum of (1) 37.5% of the "foreign-derived intangible income" (FDII) of the corporation for the taxable year plus (2) 50% of the global intangible low-taxed income (GILTI) amount (if any) that is included in the gross income of the domestic corporation under §951A for the taxable year and the amount treated as a dividend received by the corporation under §78 that is attributable to the GILTI amount included in gross income for the year. Section 250 provides that if in any year the sum of the FDII and GILTI exceed the domestic corporation's taxable income determined without regard to this section, then the amount of FDII and the amount of GILTI taken into account will be reduced before the deduction under §250(a) is computed. The deduction is also reduced for taxable years beginning after December 31, 2025 to 21.875% of FDII and 37.5% of GILTI.

FDII of a domestic corporation is the amount that bears the same ratio to the corporation's "deemed intangible income" as its "foreign-derived deduction eligible income" bears to its "deduction eligible income." For purposes of §250, a corporation's deemed intangible income

means the excess (if any) of its deduction eligible income over its deemed tangible income return. The deemed tangible income return means, with respect to any corporation, an amount equal to 10% of the corporation's qualified business asset investment (QBAI) (as defined in §951A(d), determined by substituting "deduction eligible income" for "tested income" in §951A(d)(2) and without regard to whether the corporation is a CFC. Deduction eligible income is the excess (if any) of a domestic corporation's gross income, determined without regard to a number of provisions (e.g., among others, subpart F income under §951 and GILTI inclusions under new §951A).

Taken together, the 21% corporate tax rate under amended §11 and the deductions for FDII and GILTI under new §250, yield effective tax rates of 13.125% on FDII and 10.5 % on GILTI, for taxable years beginning after December 31, 2017, and before January 1, 2026.

Effective for taxable years beginning after December 31, 2017.

Base Erosion and Anti-Abuse Tax (BEAT)

Tax on base erosion payments of taxpayers with substantial gross receipts [Act §14401; I.R.C. §59A (new), §6038A] —

Current Law

No provision.

Act

The Act adds §59A to the Code. Section 59A requires that "applicable taxpayers" pay a "base erosion minimum tax amount," which is in addition to any other income tax imposed under the Code.

An applicable taxpayer is, with respect to any taxable year, a taxpayer that: (1) is a corporation other than a regulated investment company (RIC), a real estate investment trust (REIT), or an S corporation; (2) has average annual gross receipts for the three-taxable-year-period ending with the preceding taxable year of at least $500 million; and (3) has a base erosion percentage of 3% or higher for the taxable year (2% in the case of certain banks and securities dealers). For purposes of determining if a foreign person is an applicable taxpayer, only the gross receipts taken into account when determining income effectively connected with the conduct of a trade or business within the United States are taken into account for the three-taxable-year period test. For purposes of this section, "foreign person" has the same meaning as in §6038A(c)(3).

The base erosion minimum tax amount means, with respect to any applicable taxpayer for any taxable year, the excess of 10% (5% for taxable years beginning in calendar year 2018) of the "modified taxable income" of the applicable taxpayer for the taxable year over an amount equal to the regular tax liability (as defined in §26(b)) of the taxpayer for the taxable year reduced (but not below zero) by the excess (if any) of the credits allowed under chapter 1 against such regular tax liability over the sum of: (1) the credit allowed under §38 for the taxable year that is allocable to the research credit determined under §41(a), plus (2) the portion of the applicable §38 credits not in excess of 80% of the lesser of the amount of such credits or the base erosion minimum tax amount (determined without regard to this clause (2)). For taxable years beginning after December 31, 2025, two changes are made: (1) the excess of 10% of modified taxable income is changed to 12.5%, and (2) the regular tax liability is reduced by the aggregate amount of the credits allowed under chapter 1 (and not other adjustment is made.)

For purposes of §59A, modified taxable income means the taxable income of the taxpayer computed for the taxable year, determined without regard to any base erosion tax benefit from any base erosion payment and without regard to the base erosion percentage of any net operating loss

deduction allowed under §172 for the year. The term base erosion tax benefit generally means any deduction allowed with respect to a base erosion payment for the taxable year; a base erosion payment generally means any amount paid or accrued to a foreign person that is a related party (within the meaning of §59A(g)) to the taxpayer, and with respect to which a deduction is allowable under the Code. Base erosion payments specifically include amounts paid or accrued to a foreign related person for the purchase of depreciable (or amortizable property); for any premium or other consideration paid or accrued to a foreign related person for reinsurance payments; and certain amounts paid or accrued a surrogate foreign corporation (as defined in §7874(a)(2)(B)) that is related to the taxpayer or a foreign person that is a member of the same expanded affiliated group as the surrogate foreign corporation.

There are exceptions for certain amounts paid or accrued for services, and an exception for certain qualified derivative payments made in the ordinary course of trade or business. There is also an exception for any base erosion tax benefit attributable to any base erosion payment on which tax is imposed by §871 or §882, and the tax has been deducted and withheld under §1441 or §1442, it is not taken into account in computing modified taxable income or the base erosion percentage. If the rate of tax under §871 or §882 is reduced, the exclusion would only apply in proportion to such reduction.

The base erosion percentage means, for any taxable year, the percentage determined by dividing the aggregate amount of base erosion tax benefits of the taxpayer for the taxable year by the sum of: (1) the aggregate amount of the deductions allowable to the taxpayer under §59A(c)(2)(A)(i) and (ii) for the taxable year, and (2) the base erosion tax benefits allowable to the taxpayer under §59A(c)(2)(A)(iii) and (iv) for the taxable year.

Effective for amounts paid or accrued after December 31, 2018.

The Act also adds additional reporting requirements and penalties under §6038A(b). The additional reporting requirements relate to: (1) the name, principal place of business, nature of business, and country or countries in which organized or resident, of each person which — (i) is a related party to the reporting corporation, and (ii) had any transaction with the reporting corporation during its taxable year; (2) the manner in which the reporting corporation is related to each person referred to in (1); and (3) transactions between the reporting corporation and each related foreign person. If a reporting corporation or the foreign corporation to whom §6038C applies is an applicable taxpayer, it must also report: (1) such information as the Secretary determines necessary to determine the base erosion minimum tax amount, base erosion payments, nd base erosion tax benefits of the taxpayer for the taxable year; and (2) such other information as the Secretary determines necessary to carry out §59A. The penalties for failure to furnish information or maintain records under §6038A(d)(1) and §6038A(d)(2) are increased from $10,000 to $25,000.

Amendments to §6038A are effective for taxable years beginning after December 31, 2017.

Limitations on income shifting through intangible property transfers [Act §14221; I.R.C. §367, §482, §936] —

Current Law

A transfer of intangible property to a foreign affiliate that occurs in connection with certain corporate transactions is generally not subject to the nonrecognition rules that may otherwise be applicable. The transferor of intangible property must recognize gain from the transfer as though the intangible were transferred (regardless of the stage of development of the intangible property) in exchange for payments contingent on the use, productivity, or disposition of the transferred property in amounts that would have been received either annually over the useful life of the property or upon disposition of the property after the transfer. The appropriate amounts of those imputed payments are determined using transfer-pricing principles. Final regulations eliminate an exception under temporary regulations that permitted nonrecognition of gain from outbound transfers of foreign goodwill and going concern value.

Act

The Act revises the definition of intangible property in §936(h)(3)(B) for purposes of §367(d) and §482. Under the Act, workforce in place, goodwill (both foreign and domestic), and going concern value are intangible property within the meaning of §936(h)(3)(B), as well as the residual category of "any similar item" the value of which is not attributable to tangible property or the services of an individual. The source or amount of value would not be relevant to whether property that is one of the specified types of intangible property is within the scope of the definition.

The Act clarifies that, in the case of transfers of multiple intangible properties in one or more related transactions, valuation of such intangible property on an aggregate basis is explicitly permitted if the Commissioner determines that an aggregate basis achieves a more reliable result than an asset-by-asset approach. This approach would be consistent with Tax Court decisions in cases outside of the §482 context, where collections of multiple, related intangible assets were viewed by the Tax Court in the aggregate; and also consistent with the cost-sharing regulations. Lastly, the Act codifies the realistic alternative principle with respect to intangible property which is founded on the notion that a taxpayer will only enter into a particular transaction if none of its realistic alternatives is economically preferable to the transaction under consideration.

Effective for transfers in taxable years beginning after December 31, 2017.

Certain related party amounts paid or accrued in hybrid transactions or with hybrid entities [Act §14222; I.R.C. §267A (new)] —

Current Law

No provision.

Act

The Act denies a deduction for any disqualified related party amount paid or accrued pursuant to a hybrid transaction or by, or to, a hybrid entity. Any interest or royalty paid or accrued to an related party may constitute a disqualified related party amount in one or two ways: (1) if there is no corresponding inclusion to the related party under the tax law of the country of which such related party is a resident; or (2) if such related party is allowed a deduction with respect to such amount under the tax law of such country. However, any such payments that are included in gross income of a U.S. shareholder under §951(a) would be excluded from disqualified related party amount.

The Act provides that a related party, for these purposes, would be determined under the rules of §954(d)(3), except that such section applies with respect to the payor as opposed to the CFC as otherwise referred to in that section. A hybrid transaction is any transaction, series of transactions, agreement, or instrument one or more payments with respect to which are treated as interest or royalties for federal income tax purposes and which are not so treated for purposes of the tax law of the foreign country of which the recipient of such payment is resident for tax purposes or is subject to tax. A hybrid entity is any entity which is either: (1) treated as fiscally transparent for federal income tax purposes but not so treated for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax, or (2) treated as fiscally transparent for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax but not so treated for federal income tax purposes.

The Act grants the Secretary broad authority to issue regulations or other guidance as may be necessary or appropriate to carry out the purposes of the bill; including rules for applying the provisions to branches (whether domestic or foreign), rules applying the provisions to domestic entities, and rules providing for exceptions to the general rule set forth in the provision.

Effective for taxable years beginning after December 31, 2017.

Surrogate foreign corporations not eligible for reduced rate on dividends [Act §14223; I.R.C. §1] —

Current Law

Individuals are taxed at long-term capital gain rates on certain qualified dividends from domestic corporations and from foreign corporations that satisfy certain requirements under §1(h)(11).

Act

The Act provides that any individual shareholder who receives a dividend from a corporation that first becomes a surrogate foreign corporation (as defined in §7874(a)(2)(B)) after the date of enactment, other than a foreign corporation which is treated as a domestic corporation under §7874(b), will not be entitled to the lower rates on qualified dividends provided for in §1(h).

Effective for dividends received after December 22, 2017 (the date of enactment).

Other International Reforms

Restriction on insurance business exception to passive foreign investment company rules [Act §14501; I.R.C. §1297] —

Current Law

U.S. shareholders of a passive foreign investment company (PFIC) are taxed on the PFIC's earnings. A PFIC is defined as any foreign corporation (1) 75% or more of the gross income of which is passive, or (2) at least 50% of the assets of which produce passive income. Among other exceptions, passive income does not include any income that is derived in the active conduct of an insurance business if the PFIC is predominantly engaged in an insurance business and would be taxed as an insurance company were it a U.S. corporation.

Act

The Act restricts the PFIC insurance exception to apply only if a foreign corporation is treated as a qualifying insurance corporation (QIC). Under the Act, a foreign corporation is treated as a QIC if: (1) it would be taxed as an insurance company if it were a U.S. corporation; and (2) its applicable insurance liabilities (including loss and loss adjustment expenses, unearned premiums, and certain reserves) exceed 25% of the foreign corporation's total assets (more-than 25% threshold). The exception may also be available if a foreign corporation does not qualify as a QIC solely because it fails the more-than 25% threshold but its applicable insurance liabilities do not fall below 10% of the foreign corporation's total assets. Under such circumstances, the exception would still be available if the U.S. person owning stock in the corporation elects to treat the corporation as a QIC, and under regulations, the foreign corporation is treated as predominantly engaged in an insurance business and would have satisfied the more-than 25% threshold but for certain temporary circumstances involving its insurance business.

Effective for taxable years beginning after December 31, 2017.

Repeal of fair market value of interest expense apportionment [Act §14502; I.R.C. §864] —

Current Law

Generally, interest expense may be allocated and apportioned under either the asset method or the modified gross income method. Under the asset method, taxpayers are permitted to use either the tax basis or the fair market value of their assets.

Act

The Act prohibits members of a U.S. affiliated group from allocating interest expense on the basis of the fair market value of assets for purposes of §864(e). Instead, the members must allocate interest expense based on the adjusted tax basis of assets.

Effective for taxable years beginning after December 31, 2017.

EXEMPT ORGANIZATIONS

Unrelated Business Income Tax

Unrelated business taxable income increased by amount of certain fringe benefit expenses for which deduction is disallowed [Act §13703; I.R.C. §512] —

Current Law

Tax-exempt entities are allowed to provide their employees with fringe benefits in the same manner as taxable entities. Such fringe benefits include transportation fringe benefits, any parking facility used in connection with qualified parking, or any on-premises athletic facility or other athletic facilities. These benefits can be provided free from tax to either the employer or employee.

Act

The Act provides that tax-exempt entities will be taxed on the value of fringe benefits provided to their employees by treating the funds used to pay for such benefits as unrelated business taxable income. The provision does not apply to fringe benefits directly connected with an unrelated trade or business which is regularly carried on by the organization.

Effective for amounts paid or incurred after December 31, 2017.

Unrelated business taxable income separately computed for each trade or business [Act §13702; I.R.C. §512] —

Current Law

Under regulations, a tax-exempt organization that operates more than one unrelated trade or business calculates its UBTI on a gross basis, allowing for the aggregating of income and deductions across all such business in determining the organization's taxable income. This allows an organization to offset income derived from one trade or business with deductions derived from another trade or business.

Act

The Act modifies UBTI to require an organization that operates more than one unrelated trade or business to separately calculate UBTI for each trade or business — in effect prohibiting an organization from using a deduction derived from one trade or business to offset income derived from another.

Effective for taxable years beginning after December 31, 2017, with a special rule for net operating loss carryovers.

Excise Taxes

Excise tax on investment income of private colleges and universities [Act §13701; I.R.C. §4968 (new)] —

Current Law

Colleges and universities are not subject to the 2% excise tax on their net investment income that applies to private foundations.

Act

The Act imposes a new 1.4% excise tax on the net investment income of certain private colleges and universities. This provision would apply only to private institutions that have more than 500 students, 50% of which are located within the United States, and assets of at least $500,000 per full-time student equivalent valued at the close of the preceding tax year (not including assets used directly by the institution in carrying out the institution's educational purpose). The Act includes the assets and net investment income of organizations related to the college or university in determining the application and calculation of the tax. The Act clarifies that for purposes of the related-party rules only assets held by the related party for the educational institution and investment income related to such assets are included in determining the application and calculation of the tax. In addition, the Act clarifies that the number of full-time students for purposes of determining application of the tax will be determined by taking the daily average number of full-time students (using a full-time equivalency for any part-time students).

Effective for taxable years beginning after December 31, 2017.

Excise tax on tax-exempt organization executive compensation [Act §13602; I.R.C. §4960 (new)] —

Current Law

There is a $1 million per year limitation on the compensation deduction for certain employees of a publicly held corporation (with exceptions for certain types of compensation). There are also deduction limitations on certain "parachute payments." There are currently no such limitations on the compensation for employees of tax-exempt entities.

Act

The Act imposes an excise tax on compensation in excess of $1 million paid to any of a tax-exempt organization's five highest-paid employees (and any employee who was one of the organization's five highest-paid employees for any tax year beginning after 2016 even if no longer employed by the organization). The amount of the excise tax is the corporate tax rate under §11 (set at 21% under the Act). The tax is imposed on the employer and applies to all remuneration (including non-cash benefits), except for payments to tax-qualified retirement plans and amounts that are excludible from the executive's gross income. This provision also applies to "excess parachute payments" which are parachute payments made to such individuals when the payment is contingent on the employee's separation from service and the present value of the payments is three times or more greater than the employee's base compensation or more (calculated as the average compensation includible in the employee's gross income for the five years ending before separation from service). The rules applicable in determining when compensation is no longer subject to a substantial risk of forfeiture for purposes of compensation-related provisions (set forth in §457(f)(3)(B)) applies in determining compensation subject to the tax. In addition, the Act exempts from the definition of a parachute payment, amounts paid to an employee who is not highly compensated (as defined in §414(q)). It also exempts compensation paid to qualified medical professionals for medical services rendered from the tax.

Effective for taxable years beginning after December 31, 2017.

OTHER PROVISIONS

CRAFT Beer Modernization and Tax Reform

Exempt aging period from UNICAP rules related to interest [Act §13801; I.R.C. §263A] —

Current Law

The UNICAP rules require taxpayers to capitalize interest paid or accrued during the production period of property that is allocable to the property produced by the taxpayer or acquired for resale, which: (1) has a class life of at least 20 years, (2) has an estimated production period exceeding 2 years, or (3) has an estimated production period exceeding 1 year and a cost exceeding $1 million. Property that is customarily aged before it is sold must include the aging period in the production period.

Act

The Act excludes the aging periods of beer, wine, and distilled spirits from the calculation of the production period for purposes of the UNICAP interest capitalization rules.

Effective for interest costs paid or incurred after December 31, 2017, and before January 1, 2020.

Reduced rate of excise tax on beer [Act §13802; I.R.C. §5051] —

Current Law

Beer is taxed at the rate of $18 per barrel (31 gallons). Small brewers (those that produce up to 2 million barrels during a calendar year) are taxed at $7 per barrel for the first 60,000 barrels; quantities above that amount are taxed at $18.

Act

The Act lowers the beer tax rate to $16 per barrel for the first 6 million barrels of beer brewed or imported. Quantities in excess of 6 million barrels would continue to be taxed at the current $18 per barrel rate.

The Act also lowers the beer tax rate for small brewers to $3.50 per barrel for the first 60,000 barrels domestically produced, and $16 per barrel for quantities over 60,000 barrels. The reduced tax rate could be assigned to importers importing beer produced outside the U.S., provided that the number of barrels taxed at the reduced rate does not exceed the number of barrels of beer produced by the brewer during the calendar year that were imported by the importer.

Effective for beer removed for consumption or sale after December 31, 2017, and before January 1, 2020.

Transfers of beer in bond [Act §13803; I.R.C. §5414] —

Current Law

Liability for beer excise taxes begins when beer is brewed/produced and become payable when the beer is removed from breweries for consumption or sale. Beer may be transferred between commonly owned breweries without payment of tax.

Act

The Act relaxes the shared ownership requirement under §5414, allowing brewers to transfer beer from one brewery to another without incurring tax liability, if: (1) both breweries are owned by the same person; (2) one brewery has a controlling interest in the other; (3) the same persons have a controlling interest in both breweries, or (4) the proprietors of the transferring and receiving premises are independent of each other, the transferor has divested itself of all interest in the transferred beer, and the transferee has accepted responsibility for tax payment.

Relief from liability is effective from the time of removal of the beer from a bonded premises, or at the time of divestment, whichever is later.

Effective for calendar quarters beginning after December 31, 2017, and before January 1, 2020.

Reduced rate of tax on certain wine [Act §13804; I.R.C. §5041(c)] —

Current Law

Small domestic wineries having an aggregate annual production under 250,000 gallons receive a credit of $0.90 per gallon against the wine excise tax for the first 100,000 gallons produced. The credit is reduced by 1 percent for each 1,000 gallons produced in excess of 150,000 gallons. Sparkling wines are not eligible for the credit.

Act

The Act removes the 250,000 wine gallon limitation for the wine excise tax credit, and sparkling wine producers and importers are eligible to claim the credit.

The credit is increased to the following: (1) $1.00 per wine gallon for the first 30,000 wine gallons; (2) $0.90 per wine gallon for the next 100,000 gallons; and (3) $0.535 per gallon for the next 620,000 gallons.

The credit can be assigned to foreign producers importing wine, provided that the number of wine gallons for which the credit is assigned does not exceed the number of gallons produced by the producer during the calendar year that were imported by the importer.

Effective for wine removed for consumption or sale after December 31, 2017, and before January 1, 2020.

Adjust alcohol content level of wine for application of excise taxes [Act §13805; I.R.C. §5041(b)] —

Current Law

Wine excise tax rates vary depending on alcohol content and carbonation levels. Current rates are as follows: (1) “Still wines” not more than 14% alcohol - $1.07 per wine gallon; (2) “Still wines” more than 14%t, but not more than 21%, alcohol - $1.57 per wine gallon; (3) “Still wines” more than 21%, but not more than 24%, alcohol - $3.15 per wine gallon; (4) “Still wines” more than 24% alcohol - $13.50 per proof gallon (with this percent of alcohol, wine is taxed as distilled spirits); (5) Champagne and other sparkling wines - $3.40 per wine gallon; and (6) Artificially carbonated wines - $3.30 per wine gallon.

Act

The Act increases the alcohol-by-volume percentages for the first two rate tiers to 16%t. With the increase, “still wines” with an alcohol-by-volume percentage under 16% will be taxed at the lowest rate of $1.07 per wine gallon.

Effective for wine removed for consumption or sale after December 31, 2017, and before January 1, 2020.

Definition of mead and low alcohol by volume wine [Act §13806; I.R.C. §5041] —

Current Law

Wine excise tax rates vary depending on alcohol content and carbonation levels. Champagne and other sparkling wines are taxed at $3.40 per wine gallon. Artificially carbonated wines are taxed at $3.30 per wine gallon.

Act

The Act specifies that mead and certain sparkling wines will be taxed at the lowest rate tier applicable to wine—$1.07 per wine gallon. Mead is defined as wine containing not more than 0.64 grams of carbon dioxide per 100 milliliters of wine, made solely from honey and water, without fruit product or fruit flavoring, and containing less than 8.5% alcohol-by-volume. Sparkling wines eligible for the lower rate can not contain more than 0.64 grams of carbon dioxide per 100 milliliters of wine, is derived primarily from grapes or grape juice concentrate and water, contains no fruit flavoring other than grape, and contains less than 8.5% alcohol-by-volume.

Effective for wine removed for consumption or sale after December 31, 2017, and before January 1, 2020.

Reduced excise tax rates on distilled spirits [Act §13807; I.R.C. §5001] —

Current Law

Distilled spirits are taxed a rate of $13.50 per proof gallon.

Act

The Act creates a tiered rate system for excise taxes applicable to distilled spirits. The tiers are as follows: (1) $2.70 per proof gallon for the first 100,000 proof gallons; (2) $13.34 per proof gallon for quantities above 100,000 proof gallons, but below 22.13 million proof gallons; and (3) $13.50 for quantities over 22.13 million proof gallons.

Effective for distilled spirits removed for consumption or sale after December 31, 2017, and before January 1, 2020.

Allow transfer of bonded spirits in bottles [Act §13808; I.R.C. §5212] —

Current Law

Liability for distilled spirits excise taxes begins when the spirits are created and become payable when bottled and removed from the bonded premises where they are produced. Distilled spirits may be transferred between bonded premises; transfers may be done without payment of tax if the spirits are transferred in containers that are not smaller than one gallon.

Act

The Act allows distillers to transfer distilled spirits between bonded premises in containers other than bulk containers without payment of tax.

Effective for distilled spirits transferred in bond after December 31, 2017, and before January 1, 2020.

Miscellaneous Provisions

Alaska Native Corporations and settlement trusts [Act §13821; I.R.C. §139G (new), §247 (new), §6039H] —

Current Law

Alaska Native Corporations hold property for Alaska Natives. Subject to some exceptions, Alaska Natives are generally the only permitted common shareholders. Under the Alaska Native Claims Settlement Act, a Native Corporation may transfer money or other property to an Alaska Native Settlement Trust for the benefit of beneficiaries who constitute all or a class of the shareholders of the Native Corporation, to promote the health, education, and welfare of beneficiaries and to preserve the heritage and culture of Alaska Natives.

Native Corporations and Settlement Trusts, as well as their shareholders and beneficiaries, are generally subject to tax under the same rules and in the same manner as other taxpayers that are corporations, trusts, shareholders, or beneficiaries.

A Settlement Trust may make an irrevocable election to pay tax on taxable income at the lowest rate for individuals (rather than the highest rate for trusts) and to pay tax on capital gains at a rate consistent with being subject to such lowest rate of tax. Beneficiaries generally do not recognize income on account of contributions from a Native Corporation to an electing Settlement Trust. An electing Settlement Trust is subject to the general requirements for classification and taxation as a trust.

A Settlement Trust distribution is excludible from the incomes of the beneficiaries to the extent of the taxable income of the Settlement Trust for the tax year and all prior tax years for which an election was in effect, decreased by income tax paid by the Trust, plus tax-exempt interest from state and local bonds for the same period. If the amount distributed exceeds the amount excludible, the beneficiaries must include the excess distribution amount in income as dividends, to the extent of the Native Corporation's current and accumulated E&P. Distribution amounts in excess of current and accumulated E&P are excludible from the beneficiaries' incomes.

A special loss disallowance rule reduces (but not below zero) any loss that would otherwise be recognized on disposition of stock of a sponsoring Native Corporation by a proportion, determined on a per-share basis, of all contributions to all electing Settlement Trusts by the sponsoring Native Corporation.

The trustee of an electing Settlement Trust must provide certain information relating to trust distributions in lieu of reporting under §6034A.

The election to pay tax at the lowest rate is not available in certain disqualifying cases where transfer restrictions have been modified. If an election is already in effect at the time of a disqualifying transfer, the special rules applicable to an electing trust cease to apply, and rules generally applicable to trusts apply. In addition, the distributable net income of the trust is increased by the trust's undistributed current and accumulated E&P, limited to the FMV of trust assets.

Act

The Act allows an Alaska Native Corporation to exclude from its gross income certain payments described in the Alaska Native Claims Settlement Act that it assigns to an Alaska Native Settlement Trust, provided the assignment is in writing and the Native Corporation does not receive the payment before assignment. The assigned payment will be includible in the Settlement Trust's income when received.

The Act also allows a Native Corporation to elect to deduct contributions to a Settlement Trust, up to the amount of its taxable income for the year. If the contribution is in cash, the deduction amount will be the amount of cash contributed. If the contribution is noncash property, the deduction amount will be the amount of the Native Corporation's basis in the contributed property, and no gain or loss is recognized on the contribution. Any unused deduction can be carried forward 15 years. The Native Corporation's E&P will be reduced by the amount of the deduction.

The Settlement Trust will have income equal to the deduction taken by the Native Corporation. For noncash contributions, the Settlement Trust takes a carryover basis in the property and can elect to defer recognition of income until it disposes of the property. In that case, any deferred income is treated as ordinary income, while any gain in excess of the amount deferred will have the same character as if the election had not been made. However, if the Settlement Trust were to dispose of property subject to this election within the first tax year after the tax year of contribution, the election will be voided, and the Settlement Trust will have to file an amended return for the year of contribution and pay any applicable tax on the disposition plus interest and a 10% penalty. The Act provides a four-year period during which to assess the tax, interest, and penalty amounts. The Act allows amendment of the terms of any Settlement Trust agreement to allow this election within one year of enactment, with certain restrictions.

A Native Corporation electing to deduct contributions to a Settlement Trust will be required to report to the Settlement Trust detailed information relating to contributions.

The income exclusion for payments assigned to Settlement Trusts is effective for tax years beginning after December 31, 2016. The deductibility of contributions is effective for tax years for which the Native Corporation's refund statute of limitations period has not expired, and there is a one-year waiver of the refund statute of limitations period in the event that the period expires

before the end of the one-year period beginning on December 22, 2017. The information reporting requirement applies to tax years beginning after December 31, 2016.

Aircraft management services [Act §13822; I.R.C. §4261] —

Current Law

An excise tax is imposed on amounts paid for taxable transportation (generally, air transportation that begins and ends in the United States). In general, for domestic flights, the tax consists of (1) a 7.5% ad valorem tax applied to the amount paid and (2) a flat dollar amount for each flight segment (consisting of one takeoff and one landing). The tax is paid by the person making the payment subject to tax and the tax is collected by the person receiving the payment.

Generally, aircraft management services companies provide aircraft owners, among other things, with administrative and support services (such as scheduling, flight planning, and weather forecasting), aircraft maintenance services, pilots and crew, and regulatory compliance. Although the arrangement may vary, aircraft owners generally pay aircraft management services companies a monthly fee to cover the fixed expenses of maintaining the aircraft and a variable fee to cover the cost of using the aircraft.

Recently, the IRS decided not to pursue examination of the issue of whether amounts paid to aircraft management services companies by the owners or lessors of the aircraft are taxable until further guidance is made available. According to the IRS, for any exam in suspense, the aircraft management fee issue was conceded.

Act

The Act exempts certain payments related to management of private aircraft from the excise taxes imposed on taxable air transportation. Exempt payments are amounts paid by an aircraft owner for management services related to maintenance and support of the owner's aircraft or flights on the owner's aircraft. Applicable services include support activities related to the aircraft itself, such as its storage, maintenance, and fueling, and those related to its operation, such as the hiring and training of pilots and crew, as well as administrative services such as scheduling, flight planning, weather forecasting, obtaining insurance, and establishing and complying with safety standards. Aircraft management services also include such other services as are necessary to support flights operated by an aircraft owner.

An aircraft owner includes the lessee of an aircraft, but excludes a lessee under a lease for a term of 31 days or less from a person providing aircraft management services with respect to the aircraft (or from a person related to the person providing such services). The exclusion applies on a pro rata basis to payments only a portion of which are attributable to aircraft management services.

Effective for amounts paid after the date of enactment.

Qualified opportunity zones [Act §13823; I.R.C. §1400Z-1 (new), §1400Z-2 (new)] —

Current Law

The Code contains many tax incentives to aid economically distressed areas. Many of these incentives seek to attract the investment of capital into distressed communities that may not have otherwise attracted such investment. These investments may be used to start new businesses, develop abandoned property, or provide low-income housing.

Act

The Act provides that each population census tract in each U.S. possession that is a low-income community is deemed certified and designated as a qualified opportunity zone effective on December 22, 2017. The designation of a population census tract as a qualified opportunity zone remains in effect for the period beginning on the date of the designation and ending at the close of the 10th calendar year beginning on or after the date of designation.

Second, the Act provides that the chief executive officer of the state (which includes the District of Columbia) may submit nominations for a limited number of opportunity zones to the Secretary for certification and designation. The maximum number of low-income communities that may be designated as opportunity zones depends on the number of low-income communities throughout the state. If a state contains less than 100 low-income communities, the chief executive officer may designate up to 25 tracts. If a State contains more than 100 low-income communities, the chief executive officer may designate tracts not exceed 25% of the number of low-income communities. If a chief executive officer fails to submit nominations within a certain time period then the Secretary must do so.

Temporary Deferral of Capital Gains Reinvested in an Opportunity Fund

The first tax incentive in the Act provides for the deferral of income for capital gains if the gains are reinvested in a qualified opportunity fund. The Act defines a qualified opportunity fund as an investment vehicle organized as a qualified opportunity zone that holds at least 90% of its assets in qualified opportunity zone property. The Act also provides that the certification process for a qualified opportunity fund be done by the Department of Treasury's Community Development Financial Institutions Fun (CDFI) and mirrors the process for allocating the new markets tax credit.

The Act defines a qualified opportunity zone property as any qualified opportunity zone stock, any qualified opportunity zone partnership interest, and any qualified opportunity zone business property. The Act also limits the maximum amount of gain that may be deferred to be equal to the amount invested in a qualified opportunity fund by the taxpayer during the 180-day period

beginning on the date of the sale of the asset to which the deferral pertains. The Act requires that amounts exceeding the maximum deferral amount be recognized as capital gains and, thus, be includible in gross income.

The Act additionally provides basis adjustments if an investment in a qualified opportunity zone fund is held for a certain period of time.

The Act provides the basis on the original gain increase by 10% of the original gain if the taxpayer holds the investment in the qualified opportunity zone fund for at least five years.

The Act provides that if the taxpayer holds the asset or investment for seven years, the basis will increase an additional 5% of the original gain. It also provides that the deferred gain be recognized on the earlier of (1) the date on which the qualified opportunity zone investment is disposed of or December 31, 2026. The Act provides that only taxpayers who rollover capital gains of non-zone assets before December 31, 2026, will be able to take advantage of the special treatment of capital gains for non-zone and zone realizations under the proposal. The Act provides that the basis of an investment in a qualified opportunity zone fund immediately after its acquisition is zero. However, the Act allows, if the investment is held by the taxpayer for at least five years, the basis on the investment to be increased by 10% of the deferred gain. The Act further provides that if the investment is held by the taxpayer for at least seven years, the basis on the investment is further increased by an additional 5% of the deferred gain. The Act provides that, if the investment is held by the taxpayer until at least December 31, 2026, then the basis in the investment increases by the remaining 85% of the deferred gain.

Permanent Exclusion of Capital Gains from the Sale or Exchange of an Investment in an Opportunity Fund

The second tax incentive in the Act allows for the exclusion from gross income any post-acquisition capital gains on investments in opportunity zone funds that are held for at least 10 years. The Act provides the taxpayer with an election, in the case of the sale of exchange of an investment in a qualified opportunity zone fund held for more than 10 years, to have the basis of such investment be equal to the fair market value of the investment at the date of such sale of exchange. It does not prohibit taxpayers from recognizing losses associated with investments in qualified opportunity zone funds as under current law.

Effective on December 22, 2017, but gain deferral is unavailable with respect to any sale or exchange made after December 31, 2026, or investments in qualified opportunity zones made after December 31, 2026.