“TAX CUTS AND JOBS ACT”

On December 22, President Trump signed into law H.R. 1, the “Tax Cuts and Jobs Act,” a sweeping tax reform law that will entirely change the tax landscape. The legislation reflects the largest major tax reform in over three decades.

The “Tax Cuts and Jobs Act” has largely taken shape at a breakneck speed over a two-month period, with the House passing its version of the bill on November 16 and the Senate passing its version on December 2. The two versions were then reconciled into a single piece of legislation which, due to a procedural complication, underwent a number of small revisions prior to final passage by the Senate and House. Among the few last-minute revisions to the bill was a new title: “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.” This article refers to the Act by its commonly used name: “Tax Cuts and Jobs Act” (or simply, the “Act”).

This comprehensive tax overhaul dramatically changes the rules governing the taxation of individual taxpayers for tax years beginning before 2026, providing new income tax rates and brackets, increasing the standard deduction, suspending personal deductions, increasing the child tax credit, limiting the state and local tax deduction, and temporarily reducing the medical expense threshold, among many other changes. The legislation also provides a new deduction for non-corporate taxpayers with qualified business income from pass-throughs.

For businesses, the legislation permanently reduces the corporate tax rate to 21%, repeals the corporate alternative minimum tax, imposes new limits on business interest deductions, and makes a number of changes involving expensing and depreciation. The legislation also makes significant changes to the tax treatment of foreign income and taxpayers, including the exemption from U.S. tax for certain foreign income and the deemed repatriation of off-shore income.

The “Tax Cuts and Jobs Act” is 500+ pages. The following pages highlight a number of the provisions that you may find of interest. We look forward to discussing the specifics of the “Tax Cuts and Jobs Act” provisions with you in the very near future.

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INDIVIDUALS, ESTATES & TRUSTS RATES & PROVISIONS

INDIVIDUAL TAX RATES: For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, seven tax rates apply for individuals: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The specific application of these rates, and the income brackets at which they apply, is shown below.

Single Individuals Income Tax Rates

If taxable income is:	The tax is:
Not over $9,525	10% of taxable income
Over $9,525 but not over $38,700	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $82,500	$4,453.50 plus 22% of the excess over $38,700
Over $82,500 but not over $157,500	$14,089.50 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000	$32,089.50 plus 32% of the excess over $157,500
Over $200,000 but not over $500,000	$45,689.50 plus 35% of the excess over $200,000
Over $500,000	$150,689.50 plus 37% of the excess over $500,000

Married Filing Jointly and Surviving Spouse Income Tax Rates

If taxable income is:	The tax is:
Not over $19,050	10% of taxable income
Over $19,050 but not over $77,400	$1,905 plus 12% of the excess over $19,050
Over $77,400 but not over $165,000	$8,907 plus 22% of the excess over $77,400
Over $165,000 but not over $315,000	$28,179 plus 24% of the excess over $165,000
Over $315,000 but not over $400,000	$64,179 plus 32% of the excess over $315,000
Over $400,000 but not over $600,000	$91,379 plus 35% of the excess over $400,000
Over $600,000	$161,379 plus 37% of the excess over $600,000

Married Filing Separate Income Tax Rates

If taxable income is:	The tax is:
Not over $9,525	10% of taxable income
Over $9,525 but not over $38,700	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $82,500	$4,453.50 plus 22% of the excess over $38,700
Over $82,500 but not over $157,500	$14,089.50 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000	$32,089.50 plus 32% of the excess over $157,500
Over $200,000 but not over $300,000	$45,689.50 plus 35% of the excess over $200,000
Over $300,000	$80,689.50 plus 37% of the excess over $300,000

Head of Household Income Tax Rates

If taxable income is:	The tax is:
Not over $13,600	10% of taxable income
Over $13,600 but not over $51,800	$1,360 plus 12% of the excess over $13,600
Over $51,800 but not over $82,500	$5,944 plus 22% of the excess over $51,800
Over $82,500 but not over $157,500	$12,698 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000	$30,698 plus 32% of the excess over $157,500
Over $200,000 but not over $500,000	$44,298 plus 35% of the excess over $200,000
Over $500,000	$149,298 plus 37% of the excess over $500,000

ESTATES AND TRUST TAX RATES: The Act also provides four tax rates for estates and trusts: 10%, 24%, 35%, and 37%.

If taxable income is:	The tax is:
Not over $2,550	10% of taxable income
Over $2,550 but not over $9,150	$255 plus 24% of the excess over $2,550
Over $9,150 but not over $12,500	$1,839 plus 35% of the excess over $9,150
Over $12,500	$3,011.50 plus 37% of the excess over $12,500

STANDARD DEDUCTION: For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the standard deduction is increased to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other taxpayers, adjusted for inflation in tax years beginning after 2018. No changes are made to the current-law additional standard deduction for the elderly and blind.

PERSONAL EXEMPTIONS SUSPENDED: For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the deduction for personal exemptions is effectively suspended by reducing the exemption amount to zero. A number of corresponding changes are made throughout the Code where specific provisions contain references to the personal exemption amount in Code Sec. 151(d), and in each of these instances, the dollar amount to be used is $4,150, as adjusted by inflation.

KIDDIE TAX MODIFIED: For tax years beginning after Dec. 31, 2017, the taxable income of a child attributable to earned income is taxed under the rates for single individuals, and taxable income of a child attributable to net unearned income is taxed according to the brackets applicable to trusts and estates (see above). This rule applies to the child's ordinary income and his or her income taxed at preferential rates.

CAPITAL GAINS PROVISIONS CONFORMED: The Act generally retains present-law maximum rates on net capital gains and qualified dividends.

The 15% breakpoint is: $77,200 for joint returns and surviving spouses (half this amount for married taxpayers filing separately), $51,700 for heads of household, $2,600 for trusts and estates, and $38,600 for other unmarried individuals.

The 20% breakpoint is $479,000 for joint returns and surviving spouses (half this amount for married taxpayers filing separately), $452,400 for heads of household, $12,700 for estates and trusts, and $425,800 for other unmarried individuals.

AMT RETAINED, WITH HIGHER EXEMPTION AMOUNTS: For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Act increases the AMT exemption amounts for individuals as follows:

- For joint returns and surviving spouses, $109,400.
- For single taxpayers, $70,300.
- For marrieds filing separately, $54,700.

Under the Act, the above exemption amounts are reduced (not below zero) to an amount equal to 25% of the amount by which the AMTI of the taxpayer exceeds the phase-out amounts, increased as follows:

- For joint returns and surviving spouses, $1 million.
- For all other taxpayers (other than estates and trusts), $500,000.

For trusts and estates, the base figure of $22,500 and phase-out amount of $75,000 remain unchanged.

REPEAL OF OBAMACARE INDIVIDUAL MANDATE: For months beginning after Dec. 31, 2018, the amount of the individual shared responsibility payment is reduced to zero. *This repeal is permanent.*

Observation According to the Congressional Budget Office (CBO), reducing the penalty to zero would raise approximately $338 billion over the 10-year budgetary window period because, when no longer penalized for not doing so, fewer people would obtain subsidized coverage.

Observation The Act leaves intact the 3.8% net investment income tax and the 0.9% additional Medicare tax, both enacted by Obamacare.

STATE AND LOCAL TAX DEDUCTION LIMITED: For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, subject to the exception described below, State, local, and foreign property taxes, and State and local sales taxes, are deductible only when paid or accrued in carrying on a trade or business or an activity described in Code Sec. 212 (generally, for the production of income). State and local income, war profits, and excess profits are not allowable as a deduction.

However, a taxpayer may claim an itemized deduction of 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 activity described in Code Sec. 212; and (ii) State and local income, war profits, and excess profits taxes (or sales taxes in lieu of income, etc. taxes) paid or accrued in the tax year. Foreign real property taxes may not be deducted.

Prepayment provision. For tax years beginning after Dec. 31, 2016, in the case of an amount paid in a tax year beginning before Jan. 1, 2018 with respect to a State or local income tax imposed for a tax year beginning after Dec. 31, 2017, the payment will be treated as paid on the last day of the tax year for which such tax is so imposed for purposes of applying the above limits. In other words, a taxpayer who, in 2017, pays an income tax that is imposed for a tax year after 2017, cannot claim an itemized deduction in 2017 for that prepaid income tax.

MORTGAGE & HOME EQUITY INDEBTEDNESS INTEREST DEDUCTION LIMITED: For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the deduction for interest on home equity indebtedness is suspended, and the deduction for mortgage interest is limited to underlying indebtedness of up to $750,000 ($375,000 for married taxpayers filing separately). For tax years after Dec. 31, 2025, the prior $1 million/$500,000 limitations are restored, and a taxpayer may treat up to these amounts as acquisition indebtedness regardless of when the indebtedness was incurred. The suspension for home equity indebtedness also ends for tax years beginning after Dec. 31, 2025.

Treatment of indebtedness incurred on or before Dec. 15, 2017. The new lower limit does not apply to any acquisition indebtedness incurred before Dec. 15, 2017.

“Binding contract” exception. A taxpayer who has entered into a binding written contract before Dec. 15, 2017 to close on the purchase of a principal residence before Jan. 1, 2018, and who purchases such residence before Apr. 1, 2018, shall be considered to incur acquisition indebtedness prior to Dec. 15, 2017.

Refinancing. The $1 million/$500,000 limitations continue to apply to taxpayers who refinance existing qualified residence indebtedness that was incurred before Dec. 15, 2017, so long as the indebtedness resulting from the refinancing does not exceed the amount of the refinanced indebtedness.

MEDICAL EXPENSE DEDUCTION THRESHOLD TEMPORARILY REDUCED: For tax years beginning after Dec. 31, 2016 and ending before Jan. 1, 2019, the threshold on medical expense deductions is reduced to 7.5% for all taxpayers.

CHARITABLE CONTRIBUTION DEDUCTION LIMITATION INCREASED: For contributions made in tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the 50% limitation under Code Sec. 170(b) for cash contributions to public charities and certain private foundations is increased to 60%. Contributions exceeding the 60% limitation are generally allowed to be carried forward and deducted for up to five years, subject to the later year's ceiling.

NO DEDUCTION FOR AMOUNTS PAID FOR COLLEGE ATHLETIC SEATING RIGHTS: Under Pre-Act law, special rules applied to certain payments to institutions of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event. The payor could treat 80% of a payment as a charitable contribution where: (1) the amount was paid to or for the benefit of an institution of higher education (i.e., generally, a school with a regular faculty and curriculum and meeting certain other requirements); and (2) such amount would be allowable as a charitable deduction but for the fact that the taxpayer receives (directly or indirectly) as a result of the payment the right to purchase tickets for seating at an athletic event in an athletic stadium of such institution.

New law. For contributions made in tax years beginning after Dec. 31, 2017, no charitable deduction is allowed for any payment to an institution of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event.

MISCELLANEOUS ITEMIZED DEDUCTIONS SUSPENDED: For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the deduction for miscellaneous itemized deductions that are subject to the 2% floor is suspended. Miscellaneous itemized deductions include unreimbursed employee expenses, tax preparation fees, and investment expenses.

OVERALL LIMITATION ("PEASE" LIMITATION) ON ITEMIZED DEDUCTIONS SUSPENDED: Under Pre-Act law, higher-income taxpayers who itemized their deductions were subject to a limitation on these deductions (commonly known as the "Pease limitation"). For taxpayers who exceed the threshold, the otherwise allowable amount of itemized deductions was reduced by 3% of the amount of the taxpayers' adjusted gross income exceeding the threshold. The total reduction could not be greater than 80% of all itemized deductions, and certain itemized deductions were exempt from the Pease limitation.

New law. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the "Pease limitation" on itemized deductions is suspended.

EXCLUSION FOR MOVING EXPENSE REIMBURSEMENTS SUSPENDED: For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the exclusion for qualified moving expense reimbursements is suspended, except for members of the Armed Forces on active duty (and their spouses and dependents) who move pursuant to a military order and incident to a permanent change of station.

MOVING EXPENSES DEDUCTION SUSPENDED: For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the deduction for moving expenses is suspended, except for members of the Armed Forces on active duty who move pursuant to a military order and incident to a permanent change of station.

STUDENT LOAN DISCHARGED ON DEATH OR DISABILITY: For discharges of indebtedness after Dec. 31, 2017 and before Jan. 1, 2026, certain student loans that are discharged on account of death or total and permanent disability of the student are also excluded from gross income.

CHILD TAX CREDIT INCREASED: For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the child tax credit is increased to $2,000, and other changes are made to phase-outs and refundability during this same period, as outlined below.

Phase-out. The income levels at which the credit phases out are increased to $400,000 for married taxpayers filing jointly ($200,000 for all other taxpayers) (not indexed for inflation).

Non-child dependents. In addition, a $500 nonrefundable credit is provided for certain non-child dependents.

Refundability. The amount of the credit that is refundable is increased to $1,400 per qualifying child, and this amount is indexed for inflation, up to the base $2,000 base credit amount. The earned income threshold for the refundable portion of the credit is decreased from $3,000 to $2,500.

SSN required. No credit will be allowed to a taxpayer with respect to any qualifying child unless the taxpayer provides the child's SSN.

NEW LIMITATIONS ON "EXCESS BUSINESS LOSS": Under Pre-Act law, Code Sec. 469 provided a limitation on excess farm losses that applies to taxpayers other than C corporations.
For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Act provides that the excess farm loss limitation doesn't apply, and instead a noncorporate taxpayer's "excess business loss" is disallowed. Under the new rule, excess business losses are not allowed for the tax year but are instead carried forward and treated as part of the taxpayer's net operating loss (NOL) carryforward in subsequent tax years. This limitation applies after the application of the passive loss rules described above.

An excess business loss for the tax year is the excess of aggregate deductions of the taxpayer attributable to the taxpayer's trades and businesses, over the sum of aggregate gross income or gain of the taxpayer plus a threshold amount. The threshold amount for a tax year is $500,000 for married individuals filing jointly, and $250,000 for other individuals, with both amounts indexed for inflation.

In the case of a partnership or S corporation, the provision applies at the partner or shareholder level. Each partner's or S corporation shareholder's share of items of income, gain, deduction, or loss of the partnership or S corporation is taken into account in applying the above limitation for the tax year of the partner or S corporation shareholder; and regulatory authority is provided to apply the new provision to any other passthrough entity to the extent necessary, as well as to require any additional reporting as IRS determines is appropriate to carry out the purposes of the provision.

DEDUCTION FOR PERSONAL CASUALTY & THEFT LOSSES SUSPENDED: For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the personal casualty and theft loss deduction is suspended, except for personal casualty losses incurred in a Federally-declared disaster. However, where a taxpayer has personal casualty gains, the loss suspension doesn't apply to the extent that such loss doesn't exceed the gain.

GAMBLING LOSS LIMITATION MODIFIED: For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the limitation on wagering losses under Code Sec. 165(d) is modified to provide that all deductions for expenses incurred in carrying out wagering transactions, and not just gambling losses, are limited to the extent of gambling winnings.

DEFERRED COMP & TAX-PREFERRED ACCOUNTS

NEW DEFERRAL ELECTION FOR QUALIFIED EQUITY GRANTS: Code Sec. 83 governs the amount and timing of income inclusion for property, including employer stock, transferred to an employee in connection with the performance of services. Under Code Sec. 83(a), an employee must generally recognize income for the tax year in which the employee's right to the stock is transferable or isn't subject to a substantial risk of forfeiture. The amount includible in income is the excess of the stock's fair market value at the time of substantial vesting over the amount, if any, paid by the employee for the stock.

New Law. Generally effective with respect to stock attributable to options exercised or restricted stock units (RSUs) settled after Dec. 31, 2017 (subject to a transition rule; see below), a qualified employee can elect to defer, for income tax purposes, recognition of the amount of income attributable to qualified stock transferred to the employee by the employer. The election applies only for income tax purposes; the application of FICA and FUTA is not affected.

The election must be made no later than 30 days after the first time the employee's right to the stock is substantially vested or is transferable, whichever occurs earlier. If the election is made, the income has to be included in the employee's income for the tax year that includes the earliest of:

(1) The first date the qualified stock becomes transferable, including, solely for this purpose, transferable to the employer.

(2) The date the employee first becomes an “excluded employee” (i.e., an individual: (a) who is one-percent owner of the corporation at any time during the 10 preceding calendar years; (b) who is, or has been at any prior time, the chief executive officer or chief financial officer of the corporation or an individual acting in either capacity; (c) who is a family member of an individual described in (a) or (b); or (d) who has been one of the four highest compensated officers of the corporation for any of the 10 preceding tax years.

(3) the first date on which any stock of the employer becomes readily tradable on an established securities market;

(4) the date five years after the first date the employee's right to the stock becomes substantially vested; or

(5) the date on which the employee revokes his or her election.

The election is available for “qualified stock” (defined in Code Sec. 83(i)(2)(A), as amended by Act Sec. 13603(a)) attributable to a statutory option. In such a case, the option is not treated as a statutory option, and the rules relating to statutory options and related stock do not apply. In addition, an arrangement under which an employee may receive qualified stock is not treated as a nonqualified deferred compensation plan solely because of an employee's inclusion deferral election or ability to make the election.

Deferred income inclusion also applies for purposes of the employer's deduction of the amount of income attributable to the qualified stock. That is, if an employee makes the election, the employer's deduction is deferred until the employer's tax year in which or with which ends the tax year of the employee for which the amount is included in the employee's income as described in (1) **-** (5) above.

The new election applies for qualified stock of an eligible corporation. A corporation is treated as such for a tax year if: (1) no stock of the employer corporation (or any predecessor) is readily tradable on an established securities market during any preceding calendar year, and (2) the corporation has a written plan under which, in the calendar year, not less than 80% of all employees who provide services to the corporation in the US (or any US possession) are granted stock options, or restricted stock units (RSUs), with the same rights and privileges to receive qualified stock.

Detailed employer notice, withholding, and reporting requirements also apply with regard to the election.

As noted above, the income deferral election generally applies with respect to stock attributable to options exercised or RSUs settled after Dec. 31, 2017. However, under a transition rule, until IRS issues regs or other guidance implementing the 80% 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 of them. The penalty for a failure to provide the notice required under the provision applies to failures after Dec. 31, 2017.

EXPANDED USE OF 529 ACCOUNT FUNDS: For distributions after Dec. 31, 2017, "qualified higher education expenses" include tuition at an elementary or secondary public, private, or religious school, up to a $10,000 limit per tax year.

ORDINARY INCOME/CAPITAL GAINS TREATMENT

NEW HOLDING PERIOD REQUIRED FOR "CARRIED INTEREST": In general, the receipt of a capital interest for services provided to a partnership results in taxable compensation for the recipient. However, under a safe harbor rule, the receipt of a profits interest in exchange for services provided is not a taxable event to the recipient if the profits interest entitles the holder to share only in gains and profits generated after the date of issuance (and certain other requirements are met).

Typically, hedge fund managers guide the investment strategy and act as general partners to an investment partnership, while outside investors act as limited partners. Fund managers are compensated in two ways. First, to the extent that they invest their own capital in the funds, they share in the appreciation of fund assets. Second, they charge the outside investors two kinds of annual "performance" fees: a percentage of total fund assets, typically 2%, and a percentage of the fund's earnings, typically 20%, respectively. The 20% profits interest is often carried over from year to year until a cash payment is made, usually following the closing out of an investment. This is called a "carried interest."

Under pre-Act law, carried interests were taxed in the hands of the taxpayer (i.e., the fund manager) at favorable capital gain rates instead of as ordinary income.

New law. Effective for tax years beginning after Dec. 31, 2017, the Act effectively imposes a 3-year holding period requirement in order for certain partnership interests received in connection with the performance of services to be taxed as long-term capital gain. If the 3-year holding period is not met with respect to an applicable partnership interest held by the taxpayer, the taxpayer's gain will be treated as short-term gain taxed at ordinary income rates.

CERTAIN SELF-CREATED PROPERTY NOT TREATED AS CAPITAL ASSET: Under Pre-Act law, property held by a taxpayer (whether or not connected with the taxpayer's trade or business) is generally considered a capital asset under Code Sec. 1221(a). However, certain assets are specifically excluded from the definition of a capital asset, including inventory property, depreciable property, and certain self-created intangibles (e.g., copyrights, musical compositions).

New law. Effective for dispositions after Dec. 31, 2017, the Act amends Code Sec. 1221(a)(3), resulting in the exclusion of patents, inventions, models or designs (whether or not patented), and secret formulas or processes, which are held either by the taxpayer who created the property or by a taxpayer with a substituted or transferred basis from the taxpayer who created the property (or for whom the property was created), from the definition of a "capital asset."

ESTATE & GIFT TAX PROVISIONS

ESTATE AND GIFT TAX RETAINED, WITH INCREASED EXEMPTION AMOUNT: For estates of decedents dying and gifts made after Dec. 31, 2017 and before Jan. 1, 2026, the Act doubles the base estate and gift tax exemption amount from $5 million to $10 million. The $10 million amount is indexed for inflation occurring after 2011 and is expected to be approximately $11.2 million in 2018 ($22.4 million per married couple).

- **Observation** The language in the Act does not mention generation-skipping transfers, but because the generation-skipping transfer tax exemption amount is based on the basic exclusion amount, generation-skipping transfers will also see an increased exclusion amount.

RETIREMENT PLAN PROVISIONS

REPEAL OF THE RULE ALLOWING RECHARACTERIZATION OF IRA CONTRIBUTIONS: Under Pre-Act law, if an individual makes a contribution to an IRA (traditional or Roth) for a tax year, the individual is allowed to recharacterize the contribution as a contribution to the other type of IRA (traditional or Roth) by making a trustee-to-trustee transfer to the other type of IRA before the due date for the individual's income tax return for that year. In the case of a recharacterization, the contribution will be treated as having been made to the transferee IRA (and not the original, transferor IRA) as of the date of the original contribution. Both regular contributions and conversion contributions to a Roth IRA can be recharacterized as having been made to a traditional IRA.

New law. For tax years beginning after Dec. 31, 2017, the rule that allows a contribution to one type of IRA to be recharacterized as a contribution to the other type of IRA does not apply to a conversion contribution to a Roth IRA. Thus, recharacterization cannot be used to unwind a Roth conversion.

EXTENDED ROLLOVER PERIOD FOR ROLLOVER OF PLAN LOAN OFFSET AMOUNTS: If an employee stops making payments on a retirement plan loan before the loan is repaid, a deemed distribution of the outstanding loan balance generally occurs. Such a distribution 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.

Under pre-Act law, a plan may also provide that, in certain circumstances (for example, if an employee terminates employment), 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 employee's account balance is offset by the amount of the unpaid loan balance, referred to as a loan offset. A loan offset is treated as an actual distribution from the plan equal to the unpaid loan balance (rather than a deemed distribution), and (unlike a deemed distribution) the amount of the distribution is eligible for tax free rollover to another eligible retirement plan within 60 days. However, the plan is not required to offer a direct rollover with respect to a plan loan offset amount that is an eligible rollover distribution, and the plan loan offset amount is generally not subject to 20% income tax withholding.

New law. For plan loan offset amounts which are treated as distributed in tax years beginning after Dec. 31, 2017, the Act provides that the period during which a qualified plan loan offset amount may be contributed to an eligible retirement plan as a rollover contribution would be extended from 60 days after the date of the offset to the due date (including extensions) for filing the Federal income tax return for the tax year in which the plan loan offset occurs—that is, the tax year in which the amount is treated as distributed from the plan. A qualified plan loan offset amount is a plan loan offset amount that is treated as distributed from a qualified retirement plan, a Code Sec. 403(b) plan, or a governmental Code Sec. 457(b) plan solely by reason of the termination of the plan or the failure to meet the repayment terms of the loan because of the employee's separation from service, whether due to layoff, cessation of business, termination of employment, or otherwise. A loan offset amount under the Act (as before) is the amount by which an employee's account balance under the plan is reduced to repay a loan from the plan.

CORPORATE TAX RATES

CORPORATE TAX RATES REDUCED: For tax years beginning after Dec. 31, 2017, the corporate tax rate is a flat 21% rate.

DIVIDENDS-RECEIVED DEDCUTION PERCENTAGES REDUCED: For tax years beginning after Dec. 31, 2017, the 80% dividends received deduction is reduced to 65%, and the 70% dividends received deduction is reduced to 50%.

ALTERNATIVE MINIMUM TAX REPEALED: For tax years beginning after Dec. 31, 2017, the corporate AMT is repealed.

For tax years beginning after 2017 and before 2022, the AMT credit is refundable and can offset regular tax liability in an amount equal to 50% (100% for tax years beginning in 2021) of the excess of the minimum tax credit for the tax year over the amount of the credit allowable for the year against regular tax liability. Accordingly, the full amount of the minimum tax credit will be allowed in tax years beginning before 2022.

EXPENSING, DEPRECIATION, CAPITALIZATION

INCREASED CODE 179 EXPENSING: For property placed in service in tax years beginning after Dec. 31, 2017, the maximum amount a taxpayer may expense under Code Sec. 179 is increased to $1 million, and the phase-out threshold amount is increased to $2.5 million. For tax years beginning after 2018, these amounts (as well as the $25,000 sport utility vehicle limitation) are indexed for inflation. Property is not treated as acquired after the date on which a written binding contract is entered into for such acquisition.

"Qualified real property." The definition of Code Sec. 179 property is expanded to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging. The definition of qualified real property eligible for Code Sec. 179 expensing is also expanded to include the following improvements to nonresidential real property after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

TEMPORARY 100% COST RECOVERY OF QUALIFYING BUSINESS ASSETS: A 100% first-year deduction for the adjusted basis is allowed for qualified property acquired and placed in service after **Sept. 27, 2017**, and before Jan. 1, 2023 (after Sept. 27, 2017, and before Jan. 1, 2024, for certain property with longer production periods). Thus, the phase-down of the 50% allowance for property placed in service after Dec. 31, 2017, and for specified plants planted or grafted after that date, is repealed. The additional first-year depreciation deduction is allowed for new **and used property**. (**The Pre-Act law phase-down of bonus depreciation applies to property acquired before Sept. 28, 2017, and placed in service after Sept. 27, 2017.**)

Caution The Act refers to the new 100% depreciation deduction in the placed-in-service year as "100% expensing," but the tax break should not be confused with expensing under Code Sec. 179, which is subject to entirely separate rules (see above).

In later years, the first-year bonus depreciation deduction phases down, as follows:

- 80% for property placed in service after Dec. 31, 2022 and before Jan. 1, 2024.
- 60% for property placed in service after Dec. 31, 2023 and before Jan. 1, 2025.
- 40% for property placed in service after Dec. 31, 2024 and before Jan. 1, 2026.
- 20% for property placed in service after Dec. 31, 2025 and before Jan. 1, 2027.

For certain property with longer production periods, the beginning and end dates in the list above are increased by one year. For example, bonus first-year depreciation is 80% for long-production-period property placed in service after Dec. 31, 2023 and before Jan. 1, 2025.

First-year bonus depreciation sunsets after 2026.

For productions placed in service after Sept. 27, 2017, qualified property eligible for a 100% first-year depreciation allowance includes qualified film, television and live theatrical productions. 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).

For certain plants bearing fruit or nuts planted or grafted after Sept. 27, 2017, and before Jan. 21, 2023, the 100% first-year deduction is also available.

For the first tax year ending after Sept. 27, 2017, a taxpayer can elect to claim 50% bonus first-year depreciation (instead of claiming a 100% first-year depreciation allowance).

The election to accelerate AMT credits in lieu of bonus depreciation is repealed.

LUXURY AUTOMOBILE DEPRECIATION LIMITS INCREASED: For passenger automobiles placed in service after Dec. 31, 2017, in tax years ending after that date, for which the additional first-year depreciation deduction under Code Sec. 168(k) is not claimed, the maximum amount of allowable depreciation is 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 in the recovery period. For passenger automobiles placed in service after 2018, these dollar limits are indexed for inflation. For passengers autos eligible for bonus first-year depreciation, the maximum first-year depreciation allowance remains at $8,000.

In addition, computer or peripheral equipment is removed from the definition of listed property, and so is not subject to the heightened substantiation requirements that apply to listed property.

For passenger automobiles acquired before Sept. 28, 2017, and placed in service after Sept. 27, 2017, the pre-Act phase-down of the Code Sec. 280F increase amount in the limitation on the depreciation deductions applies.

RECOVERY PERIOD FOR REAL PROPERTY SHORTENED: For property placed in service after Dec. 31, 2017, the separate definitions of qualified leasehold improvement, qualified restaurant, and qualified retail improvement property are eliminated, a general 15-year recovery period and straight-line depreciation are provided for qualified improvement property, and a 20-year ADS recovery period is provided for such property.

Thus, qualified improvement property placed in service after Dec. 31, 2017, is generally depreciable over 15 years using the straight-line method and half-year convention, without regard to whether the improvements are property subject to a lease, placed in service more than three years after the date the building was first placed in service, or made to a restaurant building. Restaurant building property placed in service after Dec. 31, 2017, that does not meet the definition of qualified improvement property, is depreciable as nonresidential real property, using the straight-line method and the mid-month convention.

For property placed in service after Dec. 31, 2017, the ADS recovery period for residential rental property is shortened from 40 years to 30 years.

For tax years beginning after Dec. 31, 2017, an electing farming business—i.e., a farming business electing out of the limitation on the deduction for interest—must use ADS to depreciate any property with a recovery period of 10 years or more (e.g., a single purpose agricultural or horticultural structures, trees or vines bearing fruit or nuts, farm buildings, and certain land improvements).

BUSINESS DEDUCTIONS, EXCLUSIONS & CREDITS

LIMITS ON DEDUCTION OF BUSINESS INTEREST: For tax years beginning after Dec. 31, 2017, every business, regardless of its form, is generally subject 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 is determined at the tax filer level. However, a special rule applies to pass-through entitles, which requires the determination to be made at the entity level, for example, at the partnership level instead of the partner level.

For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2022, adjusted taxable income is computed without regard to deductions allowable for depreciation, amortization, or depletion and without the former Code Sec. 199 deduction (which is repealed effective Dec. 31, 2017).

The amount of any business interest not allowed as a deduction for any taxable year is treated as business interest paid or accrued in the succeeding taxable year. Business interest may be carried forward indefinitely, subject to certain restrictions applicable to partnerships (see below).

Exemptions. An exemption from these rules applies for taxpayers (other than tax shelters) ***with average annual gross receipts for the three-tax year period ending with the prior tax year that do not exceed $25 million.*** The business-interest-limit provision does not apply to certain regulated public utilities and electric cooperatives. Real property trades or businesses can elect out of the provision if they use ADS to depreciate applicable real property used in a trade or business. Farming businesses can also elect out if they use ADS to depreciate any property used in the farming business with a recovery period of ten years or more. An exception from the limitation on the business interest deduction is also provided for floor plan financing (i.e., financing for the acquisition of motor vehicles, boats or farm machinery for sale or lease and secured by such inventory).

Partnerships. The limit on the amount allowed as a deduction for business interest is increased by a partner's distributive share of the partnership's excess taxable income. The excess taxable income for any partnership is the amount which bears the same ratio to the partnership's adjusted taxable income as the excess (if any) of 30% of the adjusted taxable income of the partnership over the amount (if any) by which the business interest of the partnership, reduced by floor plan financing interest, exceeds the business interest income of the partnership bears to 30% of the adjusted taxable income of the partnership. As a result, a partner of a partnership can deduct additional interest expense the partner may have paid or incurred to the extent the partnership could have deducted more business interest. Excess taxable income is allocated in the same manner as non-separately stated income and loss. Similar to these rules also apply to S corporations.

Special rule for carryforward of disallowed partnership interest. In the case of a partnership, any business interest that is not allowed as a deduction to the partnership for the tax year is allocated to each partner in the same manner as non-separately stated taxable income or loss of the partnership. The partner may deduct its share of the partnership's excess business interest in any future year, but only against excess taxable income attributed to the partner by the partnership the activities of which gave rise to the excess business interest carryforward. Any such deduction requires a corresponding reduction in excess taxable income. In addition, when excess business interest is allocated to a partner, the partner's basis in its partnership interest is reduced (but not below zero) by the amount of such allocation, even though the carryforward does not give rise to a partner deduction in the year of the basis reduction. However, the partner's deduction in a future year for interest carried forward does not reduce the partner's basis in the partnership interest.

In the event the partner disposes of a partnership interest the basis of which has been so reduced, the partner's basis in such interest shall be increased, immediately before such disposition, by the amount that any such basis reductions exceed any amount of excess interest expense that has been treated as paid by the partner (i.e., excess interest expense that has been deducted by the partner against excess taxable income of the same partnership). This rule does not apply to S corporations and their shareholders.

MODIFICATION OF NET OPERATING LOSS DEDUCTION: For NOLs arising in tax years ending after Dec. 31, 2017, the two-year carryback and the special carryback provisions are repealed, but a two-year carryback applies in the case of certain losses incurred in the trade or business of farming.

For losses arising in tax years beginning after Dec. 31, 2017, the NOL deduction is limited to 80% of taxable income (determined without regard to the deduction). Carryovers to other years are adjusted to take account of this limitation, and, except as provided below, NOLs can be carried forward indefinitely.

DOMESTIC PRODUCTION ACTIVITIES DEDUCTION (DPAD) REPEALED. For tax years beginning after Dec. 31, 2017, the DPAD is repealed.

FIVE-YEAR WRITEOFF OF SPECIFIED R&E EXPENSES. For amounts paid or incurred in tax years beginning after Dec. 31, 2021, “specified R&E expenses” must be capitalized and amortized ratably over a 5-year period (15 years if conducted outside of the U.S.), beginning with the midpoint of the tax year in which the specified R&E expenses were paid or incurred.

Specified R&E expenses subject to capitalization include expenses for software development, but not expenses for land or for depreciable or depletable property used in connection with the research or experimentation (but do include the depreciation and depletion allowances of such property). Also excluded are exploration expenses incurred for ore or other minerals (including oil and gas). In the case of retired, abandoned, or disposed property with respect to which specified R&E expenses are paid or incurred, any remaining basis may not be recovered in the year of retirement, abandonment, or disposal, but instead must continue to be amortized over the remaining amortization period.

Use of this provision is treated as a change in the taxpayer's accounting method under Code Sec. 481, initiated by the taxpayer, and made with IRS's consent. For R&E expenditures paid or incurred in tax years beginning after Dec. 31, 2025, the provision is applied on a cutoff basis (so there is no adjustment under Code Sec. 481(a) for R&E paid or incurred in tax years beginning before Jan. 1, 2026).

EMPLOYER’S DEDUCTION FOR FRINGE BENEFIT EXPENSES LIMITED: Under current law, a taxpayer may deduct up to 50% of expenses relating to meals and entertainment. Housing and meals provided for the convenience of the employer on the business premises of the employer are excluded from the employee's gross income. Various other fringe benefits provided by employers are not included in an employee's gross income, such as qualified transportation fringe benefits

New law. For amounts incurred or paid after Dec. 31, 2017, deductions for entertainment expenses are disallowed, eliminating the subjective determination of whether such expenses are sufficiently business related; the current 50% limit on the deductibility of business meals is expanded to meals provided through an in-house cafeteria or otherwise on the premises of the employer; and deductions for employee transportation fringe benefits (e.g., parking and mass transit) are denied, but the exclusion from income for such benefits received by an employee is retained. In addition, no deduction is allowed for transportation expenses that are the equivalent of commuting for employees (e.g., between the employee's home and the workplace), except as provided for the safety of the employee.

For tax years beginning after Dec. 31, 2025, the Act will disallow 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 the employer's business premises through an employer-operated facility that meets certain requirements.

ACCOUNTING METHOD CHANGES

TAXABLE YEAR OF INCLUSION: In general, for a cash basis taxpayer, an amount is included in income when actually or constructively received. For an accrual basis taxpayer, an amount is included in income when all the events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy (i.e., when the “all events test” is met), unless an exception permits deferral or exclusion. A number of exceptions that exist to permit deferral of income relate to advance payments. An advance payment is when a taxpayer receives payment before the taxpayer provides goods or services to its customer. The exceptions often allow tax deferral to mirror financial accounting deferral (e.g., income is recognized as the goods are provided or the services are performed).

New law. Generally, for tax years beginning after Dec. 31, 2017, a taxpayer is required to recognize income no later than the tax year in which such income is taken into account as income on an applicable financial statement (AFS) or another financial statement under rules specified by IRS (subject to an exception for long-term contract income under Code Sec. 460).

The Act also codifies the current deferral method of accounting for advance payments for goods and services provided by Rev Proc 2004-34 to allow 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. In addition, it directs taxpayers to apply the revenue recognition rules under Code Sec. 452 before applying the original issue discount (OID) rules under Code Sec. 1272.

In the case of any taxpayer required by this provision to change its accounting method for its first tax year beginning after Dec. 31, 2017, such change will be treated as initiated by the taxpayer and made with IRS's consent.

Under a special effective date provision, the AFS conformity rule applies for OID for tax years beginning after Dec. 31, 2018, and the adjustment period is six years.

CASH METHOD OF ACCOUNTING: Under Pre-Act law, a corporation, or a partnership with a corporate partner, may generally only use the cash method of accounting if, for all earlier tax years beginning after Dec. 31, '85, the corporation or partnership met a gross receipts test—i.e., the average annual gross receipts the entity for the three-tax-year period ending with the earlier tax year does not exceed $5 million. Under current law, farm corporations and farm partnerships with a corporate partner may only use the cash method of accounting if their gross receipts do not exceed $1 million in any year. An exception allows certain family farm corporations to qualify if the corporation's gross receipts do not exceed $25 million. Qualified personal service corporations are allowed to use the cash method without regard to whether they meet the gross receipts test.

New law. For tax years beginning after Dec. 31, 2017, the cash method may be used by taxpayers (other than tax shelters) ***that satisfy a $25 million gross receipts test***, regardless of whether the purchase, production, or sale of merchandise is an income-producing factor. Under the gross receipts test, taxpayers with annual average ***gross receipts that do not exceed $25 million (indexed for inflation for tax years beginning after Dec. 31, 2018) for the three prior tax years are allowed to use the cash method***.

The exceptions from the required use of the accrual method for qualified personal service corporations and taxpayers other than C corporations are retained. Accordingly, qualified personal service corporations, partnerships without C corporation partners, S corporations, and other pass-through entities are allowed to use the cash method without regard to whether they meet the $25 million gross receipts test, so long as the use of the method clearly reflects income.

Use of this provision results in a change in the taxpayer's accounting method for purposes of Code Sec. 481.

ACCOUNTING FOR INVENTORIES: Under Pre-Act law, businesses that are required to use an inventory method must generally use the accrual accounting method. However, the cash method can be used for certain small businesses that meet a gross receipt test with average gross receipts of not more than $1 million ($10 million businesses in certain industries). These business account for inventory as non-incidental materials and supplies.

New law. For tax years beginning after Dec. 31, 2017, ***taxpayers that meet the $25 million gross receipts test*** are not required to account for inventories under Code Sec. 471, but rather may use an accounting method for inventories that either (1) treats inventories as non-incidental materials and supplies, or (2) conforms to the taxpayer's financial accounting treatment of inventories.

Use of this provisions results is a change in the taxpayer's accounting method for purposes of Code Sec. 481.

CAPITALIZATION AND INCLUSION OF CERTAIN EXPENSES IN INVENTORY COSTS: The uniform capitalization (UNICAP) rules generally require certain direct and indirect costs associated with real or tangible personal property manufactured by a business to be included in either inventory or capitalized into the basis of such property. However, under pre-Act law, a business with average annual gross receipts of $10 million or less in the preceding three years is not subject to the UNICAP rules for personal property acquired for resale. The exemption does not apply to real property (e.g., buildings) or personal property that is manufactured by the business.

New law. For tax years beginning after Dec. 31, 2017, any producer or re-seller that meets ***the $25 million gross receipts test*** is exempted from the application of Code Sec. 263A. The exemptions from the UNICAP rules that are not based on a taxpayer's gross receipts are retained.

Use of this provisions results is a change in the taxpayer's accounting method for purposes of Code Sec. 481.

ACCOUNTING FOR LONG-TERM CONTRACTS: Under Pre-Act law, an exception from the requirement to use the percentage-of-completion method (PCM) for long-term contracts was provided for construction companies with average annual gross receipts of $10 million or less in the preceding three years (i.e., they are allowed to instead deduct costs associated with construction when they are paid and recognize income when the building is completed).

New law. For contracts entered into after Dec. 31, 2017 in tax years ending after that date, the exception for small construction contracts from the requirement to use the PCM is expanded to apply to contracts for the construction or improvement of real property if the contract: (1) is expected (at the time such contract is entered into) to be completed within two years of commencement of the contract and (2) is performed by a taxpayer that (for the tax year in which the contract was entered into) meets the $25 million gross receipts test.

Use of this PCM exception for small construction contracts is applied on a cutoff basis for all similarly classified contracts (so there is no adjustment under Code Sec. 481(a) for contracts entered into before Jan. 1, 2018).

PASS-THROUGHS

NEW DEDUCTION FOR PASS-THROUGH INCOME: Generally for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Act adds a new section, Code Sec. 199A, "Qualified Business Income," under which a non-corporate taxpayer, including a trust or estate, who has qualified business income (QBI) from a partnership, S corporation, or sole proprietorship is allowed to deduct:

(1) the lesser of: (a) the "combined qualified business income amount" of the taxpayer, or (b) 20% of the excess, if any, of the taxable income of the taxpayer for the tax year over the sum of net capital gain and the aggregate amount of the qualified cooperative dividends of the taxpayer for the tax year; plus

(2) the lesser of: (i) 20% of the aggregate amount of the qualified cooperative dividends of the taxpayer for the tax year, or (ii) taxable income (reduced by the net capital gain) of the taxpayer for the tax year.

The "combined qualified business income amount" means, for any tax year, an amount equal to: (i) the deductible amount for each qualified trade or business of the taxpayer (defined as 20% of the taxpayer's QBI subject to the W-2 wage limit; see below); plus (ii) 20% of the aggregate amount of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership income of the taxpayer for the tax year.

QBI is generally defined as the net amount of "qualified items of income, gain, deduction, and loss" relating to any qualified trade or business of the taxpayer. For this purpose, qualified items of income, gain, deduction, and loss are items of income, gain, deduction, and loss to the extent these items are effectively connected with the conduct of a trade or business within the U.S. under Code Sec. 864(c) and included or allowed in determining taxable income for the year. If the net amount of qualified income, gain, deduction, and loss relating to qualified trade or businesses of the taxpayer for any tax year is less than zero, the amount is treated as a loss from a qualified trade or business in the succeeding tax year. QBI does not include: certain investment items; reasonable compensation paid to the taxpayer by any qualified trade or business for services rendered with respect to the trade or business; any guaranteed payment to a partner for services to the business under Code Sec. 707(c); or a payment under Code Sec. 707(a) to a partner for services rendered with respect to the trade or business.

The 20% deduction is not allowed in computing adjusted gross income (AGI), but rather is allowed as a deduction reducing taxable income.

Limitations. For pass-through entities, other than sole proprietorships, the deduction cannot exceed the greater of:

(1) 50% of the W-2 wages with respect to the qualified trade or business ("W-2 wage limit"), or

(2) the sum of 25% of the W-2 wages paid with respect to the qualified trade or business plus 2.5% of the unadjusted basis, immediately after acquisition, of all "qualified property." Qualified property is defined in Code Sec. 199A(b)(6) as meaning tangible, depreciable property which is held by and available for use in the qualified trade or business at the close of the tax year, which is used at any point during the tax year in the production of qualified business income, and the depreciable period for which has not ended before the close of the tax year.

Observation The second limitation, which was newly added to the bill during Conference, apparently allows pass-through businesses to be eligible for the deduction on the basis of owning property that qualifies under the provision (e.g., real estate).

For a partnership or S corporation, each partner or shareholder is treated as having W-2 wages for the tax year in an amount equal to his or her allocable share of the W-2 wages of the entity for the tax year. A partner's or shareholder's allocable share of W-2 wages is determined in the same way as the partner's or shareholder's allocable share of wage expenses. For an S corporation, an allocable share is the shareholder's pro rata share of an item. However, the W-2 wage limit begins phasing out in the case of a taxpayer with taxable income exceeding $315,000 for married individuals filing jointly ($157,500 for other individuals). The application of the W-2 wage limit is phased in for individuals with taxable income exceeding these thresholds, over the next $100,000 of taxable income for married individuals filing jointly ($50,000 for other individuals).

Thresholds and exclusions. The deduction does not apply to specified service businesses (i.e., trades or businesses described in Code Sec. 1202(e)(3)(A), but excluding engineering and architecture; and trades or businesses that involve the performance of services that consist of investment-type activities). However, the service business limitation begins phasing out in the case of a taxpayer whose taxable income exceeds $315,000 for married individuals filing jointly ($157,500 for other individuals), both indexed for inflation after 2018. The benefit of the deduction for service businesses is phased out over the next $100,000 of taxable income for joint filers ($50,000 for other individuals). (Code Sec. 199A(d)) The deduction also does not apply to the trade or business of being an employee.

The new deduction for pass-through income is also available to specified agricultural or horticultural cooperatives, in an amount equal to the lesser of (i) 20% of the co-op's taxable income for the tax year, or (ii) the greater of (a) 50% of the W-2 wages of the co-op with respect to its trade or business, or (b) or the sum of 25% of the W-2 wages of the cooperative with respect to its trade or business plus 2.5% of the unadjusted basis immediately after acquisition of qualified property of the cooperative.

REPEAL OF PARTNERSHIP TECHNICAL TERMINATION: For partnership tax years beginning after Dec. 31, 2017, the Code Sec. 708(b)(1)(B) rule providing for the technical termination of a partnership is repealed. The repeal does not change the pre-Act law rule of Code Sec. 708(b)(1)(A) that a partnership is considered as terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

LOOK-THROUGH RULE APPLIED TO GAIN ON SALE OF PARTNERSHIP INTEREST: ***For sales and exchanges on or after Nov. 27, 2017***, 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 must be allocated to interests in the partnership in the same manner as non-separately stated income and loss.

For sales, exchanges, and dispositions after Dec. 31, 2017, the transferee of a partnership interest must 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.

PARTNERSHIP "SUBSTANTIAL BUILT-IN LOSS" MODIFIED: In general, a partnership does not adjust the basis of partnership property following the transfer of a partnership interest unless either the partnership has made a one-time election under Code Sec. 754 to make 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. These adjustments are 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 his or her partnership interest.

Under pre-Act law, 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.

New law. For transfers of partnership interests after Dec. 31, 2017, the definition of a substantial built-in loss is modified for purposes of Code Sec. 743(d), affecting transfers of partnership interests. In addition to the present-law definition, a substantial built-in loss also exists if the transferee would be allocated 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.

CHARITABLE CONTRIBUTIONS & FOREIGN TAXES IN PARTNER'S SHARE OF LOSS: Under Pre-Act law, a partner was allowed to deduct his or her distributive share of partnership loss only to the extent of the adjusted basis of the partner's interest in the partnership at the end of the partnership year in which such loss occurred. Any excess of the loss over basis was allowed as a deduction at the end of the partnership year in which the excess was repaid to the partnership. IRS has taken the position in a private letter ruling that the Code Sec. 704(d) loss limitation on partner losses does not apply to limit the partner's deduction for its share of the partnership's charitable contributions. While the regs relating to the Code Sec. 704(d) loss limitation do not mention the foreign tax credit, a taxpayer may choose the foreign tax credit in lieu of deducting foreign taxes.

New law. For partnership tax years beginning after Dec. 31, 2017, in determining the amount of a partner's loss, the partner's distributive shares under Code Sec. 702(a) of partnership charitable contributions and taxes paid or accrued to foreign countries or U.S. possessions are taken into account. However, in the case of a charitable contribution of property with a fair market value that exceeds its adjusted basis, the partner's distributive share of the excess is not taken into account.

TREATMENT OF S CORPORATION CONVERTED TO C CORPORATION: Under present law, in the case of an S corporation that converts to a C corporation, distributions of cash by the C corporation to its shareholders during the post-termination transition period (PTTP), to the extent of the amount in the accumulated adjustment account), are tax-free to the shareholders and reduce the adjusted basis of the stock.

The PTTP is:

(1) the period beginning on the day after the last day of the corporation's last tax year as an S corporation and ending on the later of (a) the day that is one year after that day, or (b) the due date for filing the return for the corporation's last tax year as an S corporation (including extensions);

(2) the 120-day period beginning on the date of any determination (as defined in Reg. § 1.1377-2(c)) with respect to an audit of the taxpayer that follows the termination of the corporation's election and

that adjusts a Subchapter S income, loss or deduction item that arises during the S corporation period (i.e., the most recent continuous period during which the corporation was an S corporation); and

(3) the 120-day period beginning on the date of a determination that the corporation's S election had terminated for an earlier year.

New law. On the date of enactment, any Code Sec. 481(a) adjustment of an eligible terminated S corporation attributable to the revocation of its S corporation election (i.e., a change from the cash method to an accrual method) is taken into account ratably during 6-tax year period beginning with the year of change. An eligible terminated S corporation is any C corporation which (1) is an S corporation the day before the date of enactment; (2) during the 2-year period beginning on the date of enactment revokes its S corporation election; and (3) all of the owners of which on the date the S corporation election is revoked are the same owners (and in identical proportions) as the owners on the date of such enactment.

In the case of a distribution of money by an eligible terminated S corporation, the accumulated adjustments account shall be allocated to such distribution, and the distribution shall be chargeable to accumulated earnings and profits, in the same ratio as the amount of the accumulated adjustments account bears to the amount the accumulated earnings and profits.

FOREIGN PROVISIONS

PARTICIPATION EXEMPTION SYSTEM FOR FOREIGN INCOME

DEDUCTION FOR FOREIGN-SOURCE PORTION OF DIVIDENDS: Under Pre-Act law, U.S. citizens, resident individuals, and domestic corporations generally are taxed on all income, whether earned in the U.S. or abroad. Foreign 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. corporation.

New law. For tax years of foreign corporations that begin after Dec. 31, 2017, and for tax years of U.S. shareholders in which or with which such tax years of foreign corporations end, the current-law system of taxing U.S. corporations on the foreign earnings of their foreign subsidiaries when these earnings are distributed is replaced. The Act provides for an exemption (referred to here as a deduction for dividends received, or DRD) for certain foreign income. This exemption is provided for by means of a 100% deduction for the "foreign-source portion" of dividends received from specified 10% owned foreign corporations (generally, any foreign corporation other than a passive foreign investment company that is not also a controlled foreign corporation (CFC), with respect to which any domestic corporation is a U.S. shareholder) by domestic corporations that are U.S. shareholders of those foreign corporations within the meaning of Code Sec. 951(b). The foreign-source portion of a dividend from a specified 10%-owned foreign corporation is that amount which bears the ratio to the dividend as the undistributed foreign earnings of the specified 10%-owned foreign corporation bears to the total undistributed earnings of such foreign corporation.

No foreign tax credit or deduction is allowed for any taxes paid or accrued with respect to a dividend that qualifies for the DRD. There is also a provision in the Act that disallows the DRD if the domestic corporation held the stock in the foreign corporation for 180 days or less during the 361-day period beginning on the date that is 180 days before the date on which the share becomes ex-dividend with respect to the dividend.

The provision eliminates the "lock-out" effect under pre-Act law, which encourages U.S. companies to avoid bringing their foreign earnings back into the U.S.

The DRD is available only to C corporations that are not regulated investment companies (RICs) or real estate investment trusts (REITs).

SALES OR TRANSFERS INVOLVING SPECIFIED 10% -OWNED FOREIGN CORPORATIONS: Under Pre-Act law, when a U.S. corporation sells or exchanges stock in a foreign subsidiary, the gain may be considered a dividend to the extent the foreign corporation has earnings and profits (E&P) that have not already been subject to U.S. tax. If foreign business is conducted through a branch of a U.S. corporation rather than a foreign subsidiary, the corporation owes U.S. taxes on the foreign earnings and deducts losses as though they accrued directly to the U.S. corporation.

New law. In the case of the sale or exchange after Dec. 31, 2017, by a domestic corporation of stock in a foreign corporation held for one year or more, any amount received by the domestic corporation which is treated as a dividend for purposes of Code Sec. 1248, is treated as a dividend for purposes of applying Code Sec. 245A.

For dividends received in tax years that begin after Dec. 31 2017, a domestic corporate shareholder's adjusted basis in the stock of a “specified 10-percent owned foreign corporation” is reduced by an amount equal to the portion of any dividend received with respect to such stock from such foreign corporation that was not taxed by reason of a dividends received deduction allowable under Code Sec. 245A in any tax year of such domestic corporation, but only for the purpose of determining losses on sales and exchanges of the foreign corporation's stock.

If, after Dec. 31, 2017, a U.S. corporation transfers substantially all of the assets of a foreign branch to a foreign subsidiary corporation, the “transferred loss” amount (i.e., the losses incurred by the foreign branch over certain taxable income earned by the foreign branch) must generally be included in the U.S. corporation's gross income.

TREATMENT OF DEFERRED FOREIGN INCOME UPON TRANSITION TO NEW PARTICIPATION EXEMPTION SYSTEM—DEEMED REPATRIATION: Under Pre-Act law, U.S. citizens, resident individuals, and domestic corporations generally are taxed on all income, whether earned in the U.S. or abroad. Foreign 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. corporation.

New law. Under the Act, U.S. shareholders owning at least 10% of a foreign subsidiary generally must include in income, for the subsidiary's last tax year beginning before 2018, the shareholder's pro rata share of the net post-'86 historical E&P of the foreign subsidiary to the extent such E&P has not been previously subject to U.S. tax.

The portion of the E&P comprising cash or cash equivalents is taxed at a reduced rate of 15.5%, while any remaining E&P is taxed at a reduced rate of 8%.

At the election of the U.S. shareholder, the tax liability is payable over a period of up to eight years. The payments for each of the first five years equals 8% of the net tax liability. The amount of the sixth installment is 15% of the net tax liability, increasing to 20% for the seventh installment and the remaining balance of 25% in the eighth year.

The Act provides a special rule for S corporations. Their shareholders are allowed to elect to maintain deferral on such foreign income until the S corporation changes its status, sells substantially all its assets, ceases to conduct business, or the electing shareholder transfers its S corporation stock.

The Act excludes the post-'86 historical E&P from the REIT gross income tests. In addition, REITs are permitted to elect to meet their distribution requirement to REIT shareholders with respect to the accumulated deferred foreign income over an 8-year period under the same installment percentages as apply to U.S. shareholders who elect to pay the net tax liability resulting from the mandatory inclusion of pre-effective-date undistributed CFC earnings in eight installments.

PASSIVE AND MOBILE INCOME

CURRENT YEAR INCLUSION OF GLOBAL INTANGIBLE LOW-TAXED INCOME: Under Pre-Act law, a U.S. person generally was not subject to U.S. tax on foreign income earned by a foreign corporation in which it owns shares until that income was distributed to the U.S. person as a dividend. Several anti-deferral regimes modified this general rule, including the Subpart F rules.

New law. For tax years of foreign corporations that begin after Dec. 31, 2017, and for tax years of U.S. shareholders in which or with which such tax years of foreign corporations end, a U.S. shareholder of any

CFC has to include in gross income for a tax year its global intangible low-taxed income (GILTI) in a manner generally similar to inclusions of subpart F income. GILTI means, with respect to any U.S. shareholder for the shareholder's tax year, the excess (if any) of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return. The shareholder's net deemed tangible income return is an amount equal to 10% of the aggregate of the shareholder's pro rata share of the qualified business asset investment of each CFC with respect to which it is a U.S. shareholder.

GILTI does not include effectively connected income, subpart F income, foreign oil and gas income, or certain related party payments. GILTI is taxed at a rate of 10%.

Foreign tax credits are allowed for foreign income taxes paid with respect to GILTI but are limited to 80% of the foreign income taxes paid and are not allowed to be carried back or forward to other tax years.

DEDUCTION FOR FOREIGN-DERIVED INTANGIBLE INCOME AND GILTI: For tax years that begin after Dec. 31, 2017 and before Jan. 1, 2026, in the case of a domestic corporation, a deduction is allowed in an amount equal to the sum of: (i) 37.5% of the foreign-derived intangible income (FDII) of the domestic corporation for the tax year, plus (ii) 50% of the GILTI amount (if any) which is included in the gross income of the domestic corporation under Code Sec. 951A for the tax year. FDII of a domestic corporation is the amount which 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 tax years that begin after Dec. 31, 2025, the allowed deduction will decrease to (i) 21.875% of the FDII of the domestic corporation for the tax year, and (ii) 37.5% of the GILTI amount included in the gross income of the domestic corporation for the tax year.

OTHER SUBPART F MODIFICATIONS

REPEAL OF FOREIGN BASE COMPANY OIL-RELATED INCOME RULE: Subpart F income includes foreign base company income (FBCI). Under pre-Act law, foreign base company oil related income was included in the Subpart F income of U.S. Shareholders as a category of FBCI.

New law. For tax years of foreign corporations that begin after Dec. 31, 2017 and for tax years of U.S. shareholders in which or with which such tax years of foreign subsidiaries end, the Act eliminates foreign base company oil related income as a category of FBCI.

MODIFICATION OF CFC STATUS ATTRIBUTION RULES: Under Pre-Act law, a U.S. parent of a controlled foreign corporation (CFC) is subject to current U.S. tax on its pro rata share of the CFC's subpart F income. A foreign subsidiary is a CFC if it is more than 50% owned by one or more U.S. persons, each of which owns at least 10% of the foreign subsidiary. Constructive ownership rules apply in determining ownership for this purpose.

New law. For the last tax year of a foreign corporation that begins before Jan. 1, 2018, for all subsequent tax years of a foreign corporation, and for the tax years of a U.S. shareholder with or with which such tax years end, the Act amends the constructive ownership rules so that certain stock of a foreign corporation owned by a foreign person is attributed to a related U.S. person for purposes of determining whether the related U.S. person is a U.S. shareholder of the foreign corporation and, therefore, whether the foreign corporation is a CFC.

EXPANSION OF DEFINITION OF "U.S. SHAREHOLDER": Under Pre-Act law, a U.S. shareholder for CFC purposes is a U.S. person who owns 10% or more of the total combined voting power of all classes of stock entitled to vote of the foreign corporation.

New law. For the last tax year of foreign corporations beginning before Jan. 1, 2018, and for tax years of U.S. shareholders with or within which such tax years of foreign corporations end, the Act expands the definition of "U.S. shareholder" to also include any U.S. person who owns 10% or more of the total value of shares of all classes of stock of a foreign corporation.

ELIMINATION OF 30-DAY MINIMUM HOLDING PERIOD FOR CFC: Under Pre-Act law, a U.S. parent of a CFC is subject to current U.S. tax on its pro rata share of the CFC's subpart F income, but only if the U.S. parent owns stock in the foreign subsidiary for an uninterrupted period of 30 days or more during the year.

New law. For tax years of foreign corporations that begin after Dec. 31, 2017, and for tax years of U.S. shareholders in which or with which such tax years of foreign subsidiaries end, a U.S. parent is subject to current U.S. tax on the CFC's subpart F income even if the U.S. parent does not own stock in the CFC for an uninterrupted period of 30 days or more during the year.

DENIAL OF DEDUCTION FOR CERTAIN RELATED PARTY PAYMENTS: No deduction is allowed for losses from sales or exchanges of property (except in corporate liquidations), directly or indirectly, between certain related persons. Under pre-Act law, there was no explicit disallowance of a deduction for any disqualified related party amount paid or accrued under a hybrid transaction or by, or to, a hybrid entity.

New law. For tax years that begin after Dec. 31, 2017, 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. A disqualified related party amount is any interest or royalty paid or accrued to a related party to the extent that: (1) there is no corresponding inclusion to the related party under the tax law of the country of which such related party is a resident for tax purposes, or (2) such related party is allowed a deduction with respect to such amount under the tax law of such country. In general, a hybrid transaction is one that involves payment of interest or royalties that are not treated as such by the country of residence of the foreign recipient. And, in general, a hybrid entity is an entity that is treated as fiscally transparent for federal income purposes but not so treated for purposes of the tax law of the foreign country, or vice versa.

FOREIGN TAX CREDIT MODIFICATIONS

REPEAL OF INDIRECT FOREIGN TAX CREDITS; CHANGE TO CFC SHAREHOLDER DEEMED-PAID CREDIT: Under Pre-Act law, a U.S. corporation that owned at least 10% of the voting stock of a foreign corporation is allowed a deemed-paid credit for foreign income taxes paid by the foreign corporation that the U.S. corporation was treated as having paid when the income on which the foreign tax was paid was distributed to the shareholder as a dividend.

And, a 10% shareholder in a controlled foreign corporation (CFC) (a U.S. Shareholder) is allowed to take a deemed-paid credit for foreign taxes paid by the CFC on the portion of the CFC's earnings that the U.S. Shareholder is required to include in income under Subpart F.
New law. For tax years of foreign corporations that begin after Dec. 31, 2017 and for tax years of U.S. shareholders in which or with which such tax years of foreign subsidiaries end, no foreign tax credit or

deduction is allowed for any taxes (including withholding taxes) paid or accrued with respect to any dividend to which the deduction for foreign-source portion of dividends applies.

A foreign tax credit is allowed for any subpart F income that is included in the income of the U.S. shareholder on a current year basis.

SEPARATE FOREIGN TAX CREDIT LIMITATION BASKET FOR FOREIGN BRANCH INCOME: The foreign tax credit limitation is calculated separately for certain categories (or "baskets") of income. Under pre-Act law, there were two such baskets: income was either passive category income or general category income.

New law. For tax years that begin after Dec. 31, 2017, foreign branch income must be allocated to a specific foreign tax credit basket. Foreign branch income is the business profits of a U.S. person which are attributable to one or more qualified business units in one or more foreign countries.

CHANGE IN RULE FOR SOURCING INCOME FROM SALES OF INVENTORY: Under Pre-Act law, in determining the source of income for foreign tax credit purposes, up to 50% of the income from the sale of inventory property that is produced within the U.S. and sold outside the U.S. (or vice versa) may be treated as foreign-source income.

New law. For tax years that begin after Dec. 31, 2017, gains, profits, and income from the sale or exchange of inventory property produced partly in, and partly outside, the U.S. must be allocated and apportioned on the basis of the location of production with respect to the property. For example, income derived from the sale of inventory property to a foreign jurisdiction is sourced wholly within the U.S. if the property was produced entirely in the U.S., even if title passage occurred elsewhere. Likewise, income derived from inventory property sold in the U.S., but produced entirely in another country, is sourced in that country even if title passage occurs in the U.S. If the inventory property is produced partly in, and partly outside, the U.S., the income derived from its sale is sourced partly in the U.S.

ELECTION WITH RESPECT TO FOREIGN TAX CREDIT LIMITATION: Under Pre-Act law, for purposes of the limitation on the foreign tax credit, if a taxpayer sustains an overall domestic loss for any tax year, then, for each succeeding year, an amount of U.S. source taxable income equal to the lesser of:

...the full amount of the loss to the extent not carried back to prior tax years; or

...50% of the taxpayer's U.S. source taxable income for that succeeding tax year,

is recharacterized as foreign source income.

New law. For any tax year of the taxpayer that begins after Dec. 31, 2017 and before Jan. 1, 2028, the taxpayer may, with respect to pre-2018 unused overall domestic losses, elect to substitute, for the above 50% amount, a percentage greater than 50% but not greater than 100%.

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