Chapter 1: New Legislation — Business Concerns

Please note. Corrections were made to this workbook through January of 2019. No subsequent modifications were made. For clarification about acronyms used throughout this chapter, see the Acronym Glossary at the end of the Index.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

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Other chapter contributors and reviewers are listed at the front of this volume.

This chapter covers business, international, and other miscellaneous provisions contained in the Tax Cuts and Jobs Act (TCJA). Discussion of these provisions is limited to an overview. Many of these provisions are explored in detail in other 2018 *University of Illinois Federal Tax Workbook* chapters. Business and other provisions contained in the Bipartisan Budget Act of 2018 (BBA)[1] and the Consolidated Appropriations Act (CAA)[2] are also covered in this chapter.

TAX CUTS AND JOBS ACT OF 2017[3]

QUALIFIED BUSINESS INCOME DEDUCTION

Old Law

Under IRC §199, qualifying taxpayers could claim a domestic production activities deduction (DPAD) equal to 9% (except for oil and gas related income, which is 6%) of the lesser of:

- Qualified production activities income (QPAI), or
- Taxable income (adjusted gross income for individuals, estates, and trusts).

A taxpayer's QPAI is its domestic production gross receipts (DPGR), reduced by the allocable cost of goods sold and other deductions, expenses, and losses.

DPGR are generally gross receipts of the taxpayer derived from the following.

1. Any sale, exchange, or other disposition, or any lease, rental, or license of qualifying production property that was manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part within the United States
2. Any sale, exchange, or other disposition, or any lease, rental, or license of qualified film produced by the taxpayer
3. Any sale, exchange, or other disposition, or any lease, rental, or license of electricity, natural gas, or potable water produced by the taxpayer in the United States
4. Construction of real property performed in the United States by a taxpayer in the ordinary course of a construction trade or business
5. Engineering or architectural services performed in the United States for the construction of real property located in the United States.

The DPAD cannot exceed 50% of the W-2 wages paid by the taxpayer to its employees, properly allocable to the taxpayer's DPGR (i.e., the wages that the taxpayer deducts in calculating its QPAI) for the calendar year ending during the tax year.

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1. PL 115-123 (Feb. 9, 2018).
2. PL 115-141 (Mar. 23, 2018).
3. PL 115-97 (Dec. 22, 2017); *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018.

New Law

> **Note.** The 2018 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 2: Small Business Issues, contains a detailed analysis of the QBID, including examples.

The qualified business income deduction (QBID) described by §11011 of the TCJA adds §199A to the Code. The TCJA in §13305 repeals the DPAD, which was previously allowed under IRC §199. The DPAD repeal is effective for tax years beginning after December 31, 2017.

Effective for tax years beginning after December 31, 2017, and ending before January 1, 2026, the TCJA introduces a new tax deduction of **20%** of qualified business income (QBI) from U.S. domestic business activities.[4] The QBID only applies for income tax purposes. It is not a deduction for self-employment (SE) or net investment income tax (NIIT) purposes. The deduction is available to taxpayers who do not itemize their deductions, as well as those who do.[5]

Individual taxpayers with QBI from a partnership, S corporation, estate, trust, sole proprietorship and from certain rental activities can claim the QBID.[6] The amount of the **combined QBID** that taxpayers can claim is the total of the following.[7]

1. The sum of the **initial QBIDs** for each of the taxpayer's qualified businesses
2. 20% of the aggregate amount of the taxpayer's qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income for the tax year

However, this formula **only results in combined QBID** if the taxpayer has net **positive** aggregate QBI from qualified businesses **and/or positive** aggregate income from REITs and PTPs.

Qualified Business Losses.[8] When the net QBI from all qualified businesses is less than zero, the combined QBID from qualified businesses is zero (item 1 of the combined QBID formula) for the tax year. The resulting qualified business loss (QBL) is then treated as negative QBI from a separate trade or business in the taxpayer's succeeding tax year. This requirement does not affect the deductibility of the loss under other sections of the Code.

Taxpayers who have one or more businesses with QBLs but net positive overall QBI must apportion their QBLs among the businesses with positive QBI in proportion to the relative amounts of their positive QBI. The business's QBI less its allocation of losses from other businesses is its **adjusted QBI,** which becomes its QBI for the purposes of the initial QBID calculation (discussed later).[9]

Specified Service Business. The QBID attributable to **positive QBI** from a **specified service business (SSB)** is reduced[10] for taxpayers whose taxable income **exceeds** the following thresholds.[11]

- $315,000 for married filing jointly (MFJ) taxpayers
- $157,500 for all other filing statuses

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4. TCJA §11011; IRC §199A.
5. PL 115-97 (Dec. 22, 2017); *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018.
6. IRC §§199A(c)(3) and 199A(f).
7. IRC §199A(b)(1); Prop. Treas. Reg. §1.199A-1(c)(1).
8. Prop. Treas. Regs. §§1.199A-1(c)(2) and 1.199A-1(d)(2)(iii).
9. Prop. Treas. Reg. §1.199A-1(d)(2)(iii)(A).
10. IRC §199A(d).
11. IRC §199A(e)(2).

The limitation is gradually phased in for MFJ taxpayers with taxable income between $315,000 and $415,000. The phasein range is between $157,500 and $207,500 for other filing statuses. Taxpayers with SSBs that have taxable income above $415,000 (MFJ taxpayers) or $207,500 (all other taxpayers) are not entitled to a QBID.[12]

An SSB is any trade or business involving the performance of services in the following areas.

- Health
- Law
- Accounting
- Actuarial science
- Performing arts
- Consulting
- Athletics
- Financial service (including investing and investment management, and trading or dealing in securities or commodities)
- Brokerage services[13]

An SSB also includes any trade or business in which the principal asset is the reputation or skill of one or more of its employees or owners. The proposed IRC §199A regulations clarify that this definition applies to any trade or business in which a person does **one or more** of the following.[14]

1. Receives fees, compensation, or other income for endorsing products or services
2. Licenses or receives fees, compensation, or other income for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity
3. Receives fees, compensation, or other income for appearing at an event or on radio, television, or another media format

> **Observation**. The SSB definition closely resembles that of personal service corporations. Unlike that definition, SSB does not include businesses that perform architectural or engineering services.

Initial QBID. **All** taxpayers with QBI whose **taxable income** (computed before the QBID) exceeds the threshold amounts ($315,000 for MFJ taxpayers and $157,500 for all other taxpayers) are **also** subject to a W-2 wages/qualified property (QP) limit based either on **wages paid** or on **wages paid plus a capital element**. This limitation, referred to as the W-2 wages/QP limit, is the **greater** of:[15]

- **50%** of the W-2 wages paid with respect to the qualified business, **or**
- **25%** of the W-2 wages with respect to the qualified business **plus 2.5%** of the unadjusted basis immediately after acquisition of all QP.

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12. IRC §§199A(d)(3) and 199A(e)(2).
13. IRC §199A(d)(2)(A).
14. Prop. Treas. Reg. §1.199A-5(b)(2)(xiv).
15. IRC §199A(b)(2)(B).

For these taxpayers, the initial QBID for **each** business is the **lesser** of:[16]

- 20% of the QBI for that business, or
- The W-2 wages/QP limit (defined above).

For MFJ taxpayers with taxable income between $315,000 and $415,000 ($157,500 and $207,500 for other filing statuses), additional calculations are required.[17]

The taxable income phasein ranges for the **SSB** exclusion and general trades and business are indexed for inflation.

Agricultural and Horticultural Cooperatives. The QBID for a specified agricultural or horticultural cooperative is **the least of the following.**[18]

- 9% of the QPAI of the cooperative
- 9% of the cooperative's taxable income for the tax year
- 50% of the W-2 wages paid by the cooperative with respect to its trade or business

> **Note.** The 2018 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 7: Agricultural Issues and Rural Investments, contains a detailed analysis of the application of the QBID to agricultural and horticultural cooperatives.

Overall Taxable Income Limitation. The final limitation applying to the QBID is the **overall taxable income limitation** (OTI limitation), which is 20% of the taxpayer's taxable income for the tax year (after being reduced by net capital gain).[19] Consequently, the final QBID is the **lesser** of:[20]

- The combined QBID, or
- The OTI limitation.

Accuracy-Related Penalty. Substantial understatements of income tax are subject to a 20% penalty under IRC §6662. The TCJA modified the definition of substantial understatement for taxpayers claiming the QBID for tax years beginning after December 31, 2017, and ending before January 1, 2026. For taxpayers whose returns include the QBID, a substantial underpayment exists if the amount of the understatement exceeds the greater of **5%** of the tax required to be shown on the return or $5,000.[21]

> **Caution**. Given the need for clarification of various issues pertaining to the QBID, this lower accuracy threshold is onerous. This is especially the case when the tax understatement is unrelated to IRC §199A. Tax practitioners should consider including a Form 8275, *Disclosure Statement,* with the tax return if a position taken on the tax return is not otherwise adequately disclosed.

16. IRC §199A(b)(2).
17. IRC §§199A(b)(3)(B) and 199A(e)(2).
18. IRC §199A(g).
19. IRC §199A(a).
20. Ibid.
21. IRC §6662(d)(1)(C).

QUALIFIED IMPROVEMENT PROPERTY

Old Law

Generally, qualified improvement property (QIP) is defined as an improvement to the interior of a nonresidential building if such improvement is placed in service after the date the building was first placed in service. However, QIP does **not** include improvements related to the following.[22]

- The enlargement of the building
- The internal structural framework of the building
- Elevators and escalators

QIP has a depreciation recovery period of either 15 or 39 years. A 15-year recovery period applies to QIP that is any of the following.[23]

- Qualified leasehold improvement property
- Qualified restaurant property
- Qualified retail improvement property

Otherwise, the default recovery period for QIP is 39 years, which is applicable to improvements to nonresidential real property.[24]

QIP with a recovery period of less than 20 years is eligible for the 50% bonus depreciation deduction.[25]

New Law

The TCJA expands the definition of qualified real property eligible for IRC §179 expensing to include improvements to the interior of any nonresidential real property (defined as QIP). Roofs, heating, ventilation, and air-conditioning property, fire protection and alarm systems, and security systems installed on such property also constitute QIP. However, QIP does not include the enlargement of a building or improvements to elevators, escalators, or the internal structural framework of a building.

Due to a TCJA drafting error, effective for tax years beginning after December 31, 2017, the 15-year recovery period is eliminated for the following QIP.[26]

- Leasehold improvement property
- Retail improvement property
- Restaurant property

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22. IRC §168(k)(3) prior to amendment by the TCJA §13204.
23. IRC §§168(e)(3)(E)(iv), (v), and (ix) prior to amendment by the TCJA §13204.
24. IRC §168(i)(6).
25. IRC §168(k)(2)(A)(i)(I).
26. IRC §168(e)(6).

Henceforth, the recovery period for the QIP listed above reverts to 39 years.[27]

Note. The conference agreement states that the TCJA sets a general 15-year MACRS recovery period for QIP.[28] However, this provision was inadvertently omitted from the final bill. Until a technical correction is made implementing the intended 15-year recovery period, QIP placed in service after December 31, 2017, is classified as 39-year nonresidential real property.[29] QIP placed in service after December 31, 2017, does not qualify for bonus depreciation (because it has a recovery period of more than 20 years).[30]

Moreover, the following changes affect real property placed in service after December 31, 2017.

- QIP classes for 15-year leasehold improvement property, retail improvement property, and restaurant improvements and buildings are eliminated.
- A real property trade or business electing out of the interest deduction limits must use ADS to depreciate residential rental property, nonresidential real property, and QIP (effective for tax years beginning after December 31, 2017).
- The ADS recovery period for residential rental property is reduced from 40 to 30 years.

IRC §179 EXPENSING[31]

Old Law

IRC §179 expensing applies to most tangible IRC §1245 property bought for use in a taxpayer's business, other than nongrantor trusts and estates. Instead of depreciating these assets, some or all of the asset's cost can be treated as an expense and recovered in the tax year that the asset is placed in service. The annual **dollar** limitation is the maximum §179 deduction a business can claim in a tax year whereas the **investment** limitation is the maximum amount a business can invest in property qualifying for the §179 deduction without affecting the dollar limitation. The dollar limit is reduced by the amount that a taxpayer's investment in §179 property during the tax year exceeds the applicable investment limit.[32]

A taxpayer's actual §179 deduction for a tax year is the least of:[33]

1. The investment in §179 property,
2. The annual dollar limitation after any reduction required due to the investment limitation, or
3. The taxpayer's taxable income from the conduct of any active trades and businesses.

27. IRC §168(i)(6).

28. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20 Statement.pdf] Accessed on Jul. 26, 2018.

29. *The Fixtures Fix: Correcting the Drafting Error Involving the Expensing of Qualified Improvement Property.* York, Erica. May 30, 2018. Tax Foundation. [taxfoundation.org/fixtures-fix-qualified-improvement-property] Accessed on Jul. 26, 2018.

30. IRC §168(k)(2)(A)(i).

31. IRC §179 and TCJA §13101.

32. IRC §179(b).

33. Ibid.

The following table summarizes the annual dollar and investment limitations applicable in recent years.

Tax Years Beginning in:	Maximum IRC §179 Deduction Allowed	Investment Limit
2017	$510,000	$2,030,000
2016	500,000	2,010,000
2010–2015	500,000	2,000,000
2008–2009	250,000	800,000

The amount of the §179 deduction that exceeds the taxpayer's taxable income from the active conduct of a trade or business is not allowable for that tax year. Instead, this excess deduction may be carried forward to the next succeeding tax year and added to the otherwise deductible amount for that year.[34] IRC §179 deductions disallowed due to the taxpayer's taxable income may be carried forward for an unlimited number of years.

Most real property does not qualify for the §179 deduction because most real property is IRC §1250 property. Land improvements can only qualify for §179 expensing if they are §1245 property.

IRC §179 expensing is elected by completing part I of Form 4562, *Depreciation and Amortization,* and filing Form 4562 with an original tax return or a timely filed amended return. An election to deduct the cost of §179 property for a tax year can be revoked on an amended return.[35] However, the revocation is irrevocable.[36]

New Law

Effective for tax years beginning after 2017, the §179 annual dollar and investment limitations are increased to $1 million and $2.5 million, respectively. Both the annual dollar and investment limitations are adjusted annually for inflation in tax years beginning in 2019 and thereafter.[37]

Residential Tangible Personal Property. Property that is used predominantly to furnish lodging or in connection with the furnishing of lodging now also qualifies for §179 expensing. The furnishing of lodging includes beds and other furniture, refrigerators, ranges, and other equipment used in the living quarters of a lodging facility such as an apartment house, dormitory, or any other facility (or part of a facility) where sleeping accommodations are provided and let.[38]

Sport Utility Vehicle (SUV). After 2018, the $25,000 §179 expensing limit for sport utility vehicles will be adjusted for inflation.[39]

BONUS DEPRECIATION[40]

Old Law

The Job Creation and Worker Assistance Act of 2002 introduced bonus depreciation.[41] Its purpose was to hasten the recovery of capital acquisition costs, thus boosting the economy. Originally intended as a temporary economic stimulus, bonus depreciation has been available to taxpayers for most years since its inception.

34. IRC §179(b)(3)(B).

35. IRC §179(c)(2).

36. Ibid.

37. IRC §179(b)(6) as amended by the TCJA §13101.

38. IRC §179(d)(1) as amended by the TCJA §13101.

39. IRC §179(b)(6) as amended by the TCJA §13101.

40. IRC §168(k) and TCJA §13201.

41. PL 107-147 (Mar. 9, 2002).

Bonus depreciation is in addition to regular depreciation and is automatic unless the taxpayer elects out. The adjusted basis of the property is first reduced by the bonus depreciation claimed and then regular depreciation deductions are computed on the remaining basis.

Bonus depreciation is applicable for the first tax year that qualifying modified accelerated cost recovery system (MACRS) property is placed in service. The amount of the bonus depreciation deduction was 50% of the property's depreciable basis for most property placed in service after December 31, 2011. Taxpayers may elect not to take bonus depreciation. However, if they do, the election may only be revoked with the IRS's consent.[42]

Unlike §179 expensing, there is no limit on the total amount of bonus depreciation that can be claimed in any given tax year or short tax year. Bonus depreciation deductions are also allowed in full for AMT purposes. Moreover, regular depreciation deductions on property qualifying for bonus depreciation are allowed for AMT purposes even when electing out of bonus depreciation.[43]

> **Note.** For eligible property, §179 expensing is claimed first. Then, bonus depreciation is claimed. Any remaining basis is subject to MACRS.

Qualifying Property. Bonus depreciation only applies to new property (the property's original use must begin with the taxpayer). In addition, the property must be placed in service after December 31, 2007, and before January 1, 2020.[44]

Longer production period property (LPPP) and certain noncommercial aircraft (NCA) must be placed in service after December 31, 2007, and before January 1, 2021, in order to claim bonus depreciation.[45]

MACRS property qualifying for bonus depreciation includes:

- Property with a recovery period of 20 years or less,
- MACRS water utility property,
- Computer software depreciable over three years under IRC §167(f), and
- QIP.[46]

Any improvement to an interior portion of a building that is nonresidential real property is considered QIP if placed in service after the date the building was first placed in service by any person. However, improvements attributable to the enlargement of a building, any elevator or escalator, or the internal structural framework of the building are not considered QIP.[47] QIP is depreciated as MACRS 39-year nonresidential real property unless it meets the separate definitions for 15-year qualified leasehold improvement property, 15-year retail improvement property, or 15-year restaurant property.[48]

42. IRC §168(k)(7).
43. IRC §168(k)(2)(G).
44. IRC §§168(k)(2)(A)(ii) and (iii) prior to amendment by the TCJA §13201.
45. IRC §168(k)(2)(B) prior to amendment by the TCJA §13201.
46. IRC §168(k)(2)(A) prior to amendment by the TCJA §13204.
47. IRC §168(k)(3) prior to being stricken by the TCJA §13204.
48. IRC §§168(e)(3)(E)(iv),(v), and (ix) prior to amendment by the TCJA §13204.

Coordination with Long-Term Contract Accounting Method. When the percentage of completion method is used for long-term contract accounting,[49] the cost of property qualifying for bonus depreciation with a MACRS recovery period of seven years or less is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted (i.e., the cost is not reduced by any bonus depreciation claimed).[50] This applies to property placed in service in 2010 (2010 or 2011 for LPPP), and property placed in service after December 31, 2012, and before January 1, 2020 (before January 1, 2021, for LPPP).[51]

New Law

The bonus depreciation rate is increased from 50% to 100% and applies to qualified property acquired and placed in service **after September 27, 2017**, and before January 1, 2023.[52] The 100% rate is phased down for years beginning after 2022. The applicable bonus depreciation rates are shown in the following table.[53]

Calendar Year Placed in Service		Bonus
LPPP and NCA	**Other Qualifying Property**	**Depreciation Rate**
After September 27, 2017, and before 2024	After September 27, 2017, and before 2023	100%
2024	2023	80%
2025	2024	60%
2026	2025	40%
2027	2026	20%
2028 and subsequent years	2027 and subsequent years	0%

Note. The Proposed Treasury Regulations clarify that the following QIP, acquired and placed in service **after** September 28, 2017, and **before** January 1, 2018, has a 15-year life and, therefore, qualifies for 100% bonus depreciation.[54]

- Qualified leasehold improvement property
- Qualified retail improvement property
- Qualified restaurant property

Consequently, tax professionals should review 2017 client tax returns potentially affected by this Treasury clarification and file amended tax returns when appropriate.

49. IRC §460(b).
50. IRC §460(c)(6).
51. IRC §460(c)(6)(B)(ii) prior to amendment by the TCJA §13201.
52. IRC §§168(k)(1)(A) and (6)(A) as amended by the TCJA §13201.
53. IRC §168(k)(6) as amended by the TCJA §13201.
54. Prop. Treas. Regs. §§1.168(k)-2(b)(2)(i)(A) and 1.168(b)-1(a)(5).

Plants. The bonus depreciation rates shown in the preceding table also apply to specified plants acquired **after September 27, 2017**, based on when the plant was planted or grafted.[55] A specified plant for this purpose includes the following.[56]

- Any tree or vine that bears fruits or nuts
- Any other plant, which will have more than one yield of fruits or nuts and which generally has a preproductive period of more than two years from the time of planting or grafting to the time such plant begins bearing fruits or nuts

Note. See the 2018 *University of Illinois Federal Tax* Workbook, Volume A, Chapter 7: Agricultural Issues and Rural Investments, for further discussion about the treatment of plants.

Property Acquired Before September 28, 2017. A transition rule under the TCJA applies to property **acquired before September 28, 2017**, and placed in service **after September 27, 2017**. Under the provision, the applicable bonus depreciation rates for qualified property acquired before September 28, 2017, are shown in the following table.

Year Placed in Service	Qualified Property other than LPPP and NCA	LPPP and NCA
2017	50%	50%
2018	40%	50%
2019	30%	40%
2020	None	30%

Election to Apply 50% Rate. Taxpayers may elect the 50% rather than the 100% rate for qualified property placed in service during the taxpayer's first tax year ending **after September 27, 2017**. Thus, a calendar-year taxpayer can elect to apply the 50% rate to **all** qualified property placed in service in 2017. This election is made by including a statement with a timely filed return (including extensions) indicating that the taxpayer is "electing to claim a 50% special depreciation allowance on all qualified property."[57] Once this election is made, it cannot be revoked without the IRS's consent.[58]

Each person owning qualified property must make the election separately. For partnerships and S corporations, the election is made at the entity level. The common parent makes the election in the case of a controlled group.[59]

Exclusion for Property Using Floor Plan Financing Indebtedness. Certain property used in a trade or business that had floor plan financing indebtedness does not qualify for bonus depreciation. This exclusion applies when the floor plan financing interest on the indebtedness was taken into account under the new rules that limit the business interest deduction to 30% of adjusted taxable income plus floor plan financing interest and interest income.[60]

Floor plan financing indebtedness means indebtedness:

- Used to finance the acquisition of **motor vehicles** held for sale or lease, and
- That is secured by the inventory acquired.[61]

55. IRC §§168(k)(5)(A) and (6)(C).
56. IRC §168(k)(5)(B).
57. IRC §168(k)(10) as amended by the TCJA §13201; see also 2017 instructions for Form 4562.
58. IRC §168(k)(7).
59. Ibid.
60. IRC §§168(k)(9) and 163(j)(9).
61. IRC §163(j)(9).

The definition of **motor vehicle** includes all of the following types of property.

- Any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road
- A boat
- Farm machinery or equipment

Used Property Now Qualifies for Bonus Depreciation. Property acquired and placed in service after September 27, 2017, but previously used by an unrelated person qualifies for bonus depreciation if it meets the following two acquisition requirements.[62]

- The taxpayer did not use the property at any time before acquiring it.
- The taxpayer acquired the property by "purchase" within the meaning of IRC §179(d)(2).[63]

An acquisition is considered a purchase (under IRC §179(d)(2)) **unless** the property:

1. Is acquired from a close family member,[64]
2. Is acquired by one member of a controlled group of corporations from another member (substituting 50% for the 80% stock ownership requirement otherwise applicable),
3. Has a basis in the hands of the acquirer determined wholly or partly by reference to the adjusted basis of the disposing party (e.g., a gift or IRC §1022 basis property), or
4. Has its basis determined under IRC §1014(a) (relating to inherited or bequeathed property).

Film, TV, and Live Theatrical Productions. Bonus depreciation is allowed for certain qualified films, television shows, or theatrical productions placed in service after September 27, 2017. The term "placed in service" refers to the time of initial release or broadcast for a qualified film or television production and the initial live staged performance for a qualified live theatrical production.[65]

Long-Term Contract Accounting Method.[66] Relief is provided when determining the percentage of completion under IRC §460(b)(1)(A) for purposes of the long-term contract method of accounting. This relief applies to the cost of property with a MACRS recovery period of seven years or less that qualifies for bonus depreciation. Such cost is considered as a cost allocated to the contract as if the bonus depreciation had not been enacted. This provision applies to property placed in service after December 31, 2012, and before January 1, 2027 (before January 1, 2028, in the case of LPPP).

Corporate Election to Claim Unused AMT Credits in Lieu of Bonus Depreciation. Effective for tax years beginning after December 31, 2017, corporations may no longer elect to claim unused AMT credits in lieu of bonus depreciation on property placed in service during the tax year.[67]

62. IRC §168(k)(2)(A)(ii) as amended by the TCJA §13201.
63. IRC §168(k)(2)(E)(ii) as amended by the TCJA §13201.
64. As defined under IRC §§267 or 707(b) except as modified by IRC §179(d)(2)(A).
65. IRC §168(k)(2)(H) as amended by the TCJA §13201; Rev. Proc. 2018-25, 2018-18 IRB 543.
66. IRC §460(c)(6)(B) as amended by the TCJA §13201.
67. IRC §168(k)(4) prior to being stricken by the TCJA §12001.

APPLICABLE RECOVERY PERIODS FOR REAL PROPERTY[68]

Old Law[69]

Tangible property is generally depreciated under MACRS. The depreciation for different types of property is determined based on the applicable depreciation method, recovery period, and convention. The alternative depreciation system (ADS) is required for the following types of property.

- Tangible property used principally outside the United States
- Certain tax-exempt use property
- Tax-exempt bond financed property
- Certain imported property

In addition, taxpayers can elect to use ADS for any class of property for any tax year.

New Law

Effective for tax years beginning after December 31, 2017, the use of ADS for depreciating residential rental property, nonresidential real property, and QIP is required for real property trades or businesses electing out of the new interest deduction limits.[70] For this purpose, a **real property trade or business** is any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.[71]

> **Note.** Representatives from the IRS Chief Counsel's office indicated at the 2018 American Bar Association Mid-Year Meeting that future guidance will **not** require taxpayers making this election to file an accounting method change. Instead, the change in use rules[72] will apply to this election.

The **interest deduction limits** are those introduced by the TCJA that disallow a deduction for net interest expense that is more than 30% of the adjusted taxable income of a business.[73]

The following ADS periods apply for real property.

- 40 years for nonresidential real property
- 30 years (reduced from 40 years) for residential rental property placed in service after December 31, 2017[74]
- 40 years for QIP

> **Note.** A technical correction is required to change the ADS period for QIP to 20 years to conform with legislative intent.

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68. TCJA §13204.

69. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on Jul. 26, 2018.

70. IRC §§168(g)(1) and (8) as amended by the TCJA §13204.

71. IRC §469(c)(7)(C).

72. Treas. Reg. §1.168(i)-4.

73. IRC §163(j) as amended by TCJA §13301.

74. IRC §168(g)(2)(C) as amended by the TCJA §13204.

DEPRECIATION LIMITS ON LUXURY AUTOS[75]

Old Law

Annual depreciation deductions for passenger automobiles (autos) are limited to specific dollar amounts.[76] These luxury auto limits are adjusted each year for inflation.[77]

Depreciation limits are reduced for vehicles that are partly used for personal purposes.[78]

Luxury Auto Depreciation Limits. When taxpayers choose bonus depreciation, the first-year IRC §280F depreciation limit for passenger automobiles that qualify for bonus depreciation is increased by $8,000 for vehicles placed in service during 2017, $6,400 for 2018, and $4,800 for 2019.[79]

Bonus Depreciation and First-Year Depreciation Limit. The §179 expense and bonus depreciation are treated as depreciation deductions for the tax year in which a vehicle is placed in service.[80] Thus, the combined §179 deduction, bonus depreciation, and regular first-year depreciation deduction is limited to the applicable first-year depreciation limit. Depreciation deductions in subsequent years of the vehicle's recovery period are limited to the applicable limit for the applicable year in the recovery period.

Deductions disallowed by the depreciation limit are deferred until after the end of the vehicle's recovery period, when they are recovered at specified annual rates.[81]

The following table shows the luxury auto depreciation limits for vehicles placed in service in 2017.[82]

	Depreciation Allowable			
Auto Placed in Service	**Year 1**	**Year 2**	**Year 3**	**Year 4**
Calendar year 2017	$11,160 ($8,000 1st year depreciation increase + $3,160)	$5,100	$3,050	$1,875

Although the term "luxury auto limits" is used, these limits actually apply to vehicles costing more than **$18,600** in 2017 (which some would consider modestly priced). This assumes that 50% bonus depreciation is claimed and the 200% declining-balance (200% DB) method and half-year convention apply.

75. IRC §280F and TCJA §13202.

76. IRC §280F(a).

77. IRC §280F(d)(7); The depreciation limit effective for the year a vehicle is placed in service continues to apply throughout its recovery period (Rev. Proc. 2003-75, IRB 2003-45).

78. IRC §280F(a)(2).

79. IRC §168(k)(2)(F) prior to amendment by the TCJA §13201.

80. IRC §§280F(a)(1)(B) and (d)(1).

81. IRC §280F(a)(1)(B).

82. Rev. Proc. 2017-29, 2017-14 IRB 1065.

New Law

Increase in Annual Depreciation Limits for Passenger Automobiles. Effective for vehicles placed in service **after December 31, 2017,** the annual depreciation limits for passenger automobiles are shown in the following table.[83]

	Annual Depreciation Limit	
Tax Year	**100% Bonus Depreciation Not Claimed**	**100% Bonus Depreciation Claimed**
1	$10,000	$18,000
2	16,000	16,000
3	9,600	9,600
4 and subsequent	5,760	5,760

Note. Any unrecovered basis of the vehicle at the end of the recovery period is expensed in subsequent years subject to a maximum expense recovery of $5,760 per tax year.[84]

The above limits are adjusted annually for inflation for vehicles placed in service after 2018.[85] However, the $8,000 increase to the first-year limit for bonus depreciation is **not** adjusted for inflation.

Bonus Depreciation and First-Year Depreciation Limit.[86] The $8,000 increase in the first-year depreciation limit is the same whether 100% or 50% bonus depreciation is claimed. This $8,000 increase in the first-year depreciation limit is no longer subject to the phase-down specified in the old law except that the increase in the first-year depreciation limit is reduced for vehicles **acquired before** September 28, 2017, and **placed in service after** September 27, 2017. In this case, the increases in the first-year depreciation limits are $6,400 and $4,800 for vehicles placed in service in 2018 and 2019, respectively.

Depreciation Deductions after First Year if 100% Bonus Depreciation Claimed. According to IRS Tax Reform Tax Tip 2018-177, if a taxpayer claims 100% bonus depreciation on passenger vehicles, the greatest allowable depreciation deduction is shown in the last column of the preceding table.

83. IRC §280F(a)(1)(A) as amended by the TCJA §13202; IRC §168(k)(2)(F) as amended by the TCJA §13201.

84. IRC §280F(a)(1)(B) as amended by the TCJA §13202.

85. IRC §280F(d)(7) as amended by the TCJA §13202.

86. IRC §168(k)(2)(F) as amended by the TCJA §13201.

Example 1. A car (5-year MACRS property) costing $40,000, subject to the luxury car limits, is placed in service in November 2017 by a calendar-year taxpayer who claims 100% bonus depreciation on the vehicle.

Because the first-year depreciation limit for the vehicle is $11,160, the maximum depreciation deduction (including bonus depreciation) permitted is limited to $11,160.

Note. A taxpayer may elect 50% instead of 100% bonus depreciation for property placed in service during the first tax year ending after September 27, 2017.[87] Thus, for that tax year only, the adverse result in this example could have been avoided by electing the 50% bonus depreciation rate. However, this election would apply to **all** the taxpayer's 5-year property placed in service during the 2017 tax year.

$25,000 §179 Limit on Certain Vehicles Adjusted for Inflation. The $25,000 maximum §179 deduction applicable to specified vehicles exempt from the luxury auto limits is adjusted for inflation in tax years beginning after 2018.[88] This $25,000 limit applies to all of the following.[89]

- Sport utility vehicles
- Trucks with an interior cargo bed length less than six feet
- Certain vans seating fewer than 10 persons behind the driver's seat

COMPUTER EQUIPMENT NO LONGER LISTED PROPERTY[90]

Old Law

No deductions or credits can be claimed for listed property unless strict substantiation requirements are met.[91] Computers and related peripheral equipment placed in service before January 1, 2018, are considered listed property subject to these substantiation requirements. To meet these requirements, the taxpayer must substantiate the following by adequate records or by sufficient evidence corroborating the taxpayer's own statement.[92]

1. The amount of the expenditure
2. The business purpose of the expenditure
3. The percentage of business/investment expense usage of the property for the year

87. IRC §168(k)(10) as amended by the TCJA §13201.

88. IRC §179(b)(6) as amended by the TCJA §13101.

89. IRC §179(b)(5).

90. IRC §280F(d)(4)(A) and TCJA §13202.

91. IRC §274(d).

92. Temp. Treas. Regs. §§1.274-5T(a)(4) and (c).

Recapture Rules for Listed Property.[93] If listed property is not used predominantly (more than 50% of its total use) in a trade or business, the business portion of the asset must be depreciated under the ADS, and §179 expensing is not allowed.

If, in a year after the taxpayer placed an item of listed property in service, the taxpayer fails to meet the predominant use test for that item of property, they may be required to recapture part of any §179 expensing and depreciation deductions claimed in an earlier year. Beginning with the year the taxpayer no longer uses the property predominantly in a qualified business, they must depreciate the property using the straight-line method over the ADS recovery period.

In the year the business use drops to 50% or less, the taxpayer must include the recapture amount as ordinary income in part IV of Form 4797, *Sales of Business Property*.

New Law

Effective for property placed in service after December 31, 2017, computers and peripheral equipment are no longer considered listed property.[94] Consequently, the cost of computers and peripheral equipment can be deducted or depreciated like other business property, and these expenditures are no longer subject to the strict substantiation requirements of IRC §274(d).

AMORTIZATION OF RESEARCH AND EXPERIMENTAL EXPENDITURES[95]

Old Law

Taxpayers may choose from the following four methods to account for research and experimental expenditures.[96]

1. Deduct in the year paid or incurred
2. Elect to amortize over at least 60 months beginning in the month that benefits are first realized from the expenditures
3. Elect to amortize over 10 years beginning in the tax year in which they are paid or incurred
4. Capitalize the expenditures

In addition, a tax credit is available for increased research and experimental expenses.[97]

AMT Consequences for Noncorporate Taxpayers. The deduction for research and experimental costs is allowed in full for AMT purposes for noncorporate taxpayers materially participating in the activity.[98] Noncorporate taxpayers who make the 10-year amortization election are allowed the full amortization deduction for AMT purposes.[99]

Disallowed Deductions. No research and experimental deductions are generally allowed for the following expenditures.

- Acquisition or improvement of land or of depreciable or depletable property used in connection with any research or experimentation[100]
- Expenses for ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral, including oil and gas[101]

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93. IRS Pub. 946, *How To Depreciate Property.*
94. IRC §280F(d)(4)(A) as amended by the TCJA §13202.
95. IRC §174 and TCJA §13206.
96. IRC §§174 and 59(e); Treas. Regs. §§1.174-1 and 1.174-2.
97. IRC §41.
98. IRC §56(b)(2)(D) prior to redesignation as IRC §56(b)(2)(C) by the TCJA §12001.
99. IRC §59(e).
100. IRC §174(c).
101. IRC §174(d).

New Law

Specified **domestic** research or experimental expenditures paid or incurred in tax years beginning after December 31, 2021, generally must be amortized ratably over five years. By contrast, **foreign** research or experimental expenditures paid or incurred in tax years beginning after December 31, 2021, generally must be amortized ratably over 15 years.[102] For this purpose, foreign research is any research conducted outside the United States, the Commonwealth of Puerto Rico, or any U.S. possession.[103]

The amortization period begins at the mid-point of the tax year in which the expenditures are paid or incurred.[104]

After 2021, the following options are eliminated.

- Current deductions for research and experimental expenditures
- Election of an amortization period beginning when benefits are first realized

However, the option to elect 10-year amortization of research and experimental expenditures beginning in the year the expenditures are paid or incurred remains available after 2021.[105]

Software Costs. Amounts paid or incurred in connection with the development of any software are treated as research or experimental expenditures for purposes of these new amortization provisions.[106]

Amortization after Disposition. Amortization of research or experimental expenditures must continue under these new rules even if the property for which the expenditures were paid or incurred is disposed of, retired, or abandoned during the amortization period.[107]

LIKE-KIND EXCHANGES[108]

Old Law

When a taxpayer disposes of property and they receive like-kind property in exchange, capital gain or loss can be deferred. To obtain this beneficial tax treatment, property held for productive use in a trade or business or for investment must be exchanged for like-kind property that will also be held for productive use in a trade or business or for investment. This results in no gain or loss being currently recognized to the extent that like-kind property is the only property received in the transaction.[109]

Like-Kind Property. The term "like-kind" refers to property of the same nature or character. It does not refer to the grade or quality of the property. There are three categories of like-kind property.[110]

1. Depreciable tangible personal property
2. Intangible and nondepreciable personal property
3. Real property

102. IRC §174(a) as amended by the TCJA §13206.
103. IRC §174(a)(2)(B) as amended by the TCJA §13206 referencing IRC §41(d)(4)(F).
104. IRC §174(a)(2)(B) as amended by the TCJA §13206.
105. IRC §59(e).
106. IRC §174(c)(3) as amended by the TCJA §13206.
107. IRC §174(d) as amended by the TCJA §13206.
108. IRC §1031.
109. IRC §1031(a)(1) prior to amendment by the TCJA §13303.
110. Treas. Regs. §§1.1031(a)-1 and 1.1031(a)-2.

Generally, real property is considered like-kind to other real property, even when there are significant differences between them. For example, the following types of real property are considered like-kind.[111]

- Improved real estate and unimproved real estate
- Urban lots and rural tracts
- Commercial property and residential rental or investment property
- A leasehold or similar property interest with at least 30 years left to run and real estate

Ineligible Property. Property that is **ineligible** for like-kind exchange treatment includes the following.[112]

1. Foreign real estate
2. Stock in trade or inventory property held primarily for sale
3. Stocks, bonds, or notes, other than stock in a mutual ditch, reservoir, or irrigation company described in IRC §501(c)(12)(A) that is treated as real property under applicable state law
4. Other securities or evidences of indebtedness or interest
5. Partnership interests
6. Certificates of trust or beneficial interests
7. Choses in action (rights to sue)

Deferred Like-Kind Exchanges.[113] A qualifying like-kind exchange need not be simultaneous exchanges. Deferred exchanges, in which a taxpayer relinquishes property before receiving the replacement property, are possible. Conversely, deferred exchanges in which the taxpayer receives replacement property before relinquishing the surrendered property are also possible. These are known as reverse-Starker exchanges or parking transactions.

Once one property is transferred in a deferred like-kind exchange, the taxpayer must:

1. Identify the property for the second transfer within 45 days; and
2. Complete the second transfer within 180 days or, if earlier, the due date (including extensions) of the taxpayer's return for the tax year in which the first property is relinquished.

The IRS provides a safe harbor for reverse-Starker exchanges incorporating similar deadlines.[114]

New Law[115]

Effective for exchanges completed after December 31, 2017, the like-kind exchange rules only apply to exchanges of real property. No gain or loss is recognized on the exchange of **real property** held for productive use in a trade or business or for investment to the extent that real property is exchanged for like-kind **real property** held either for productive use in a trade or business or for investment. Consequently, after 2017, like-kind exchange treatment is **no longer allowed** for depreciable tangible personal property, and intangible and nondepreciable personal property.

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111. Treas. Reg. §1.1031(a)-1(c).

112. IRC §1031(h)(1) prior to amendment by the TCJA §13303; IRC §1031(i) prior to being stricken by the TCJA §13303; Treas. Reg. §1.1031(a)-1(a)(1).

113. IRC §1031(a)(3).

114. Rev. Proc. 2000-37, 2000-40 IRB 308.

115. TCJA §13303.

Transition Rule. The new law does not apply to the following exchanges.[116]

1. When property is disposed of on or before December 31, 2017
2. When property is received on or before December 31, 2017

Therefore, this transition rule permits taxpayers to complete a deferred or reverse-Starker exchange that involves depreciable tangible personal property or intangible and nondepreciable personal property within the 45-day and the 180-day exchange deadlines.

Ineligible Property. The following types of property continue to be ineligible for like-kind exchange treatment.[117]

- Real property held primarily for sale
- Foreign real property

Note. The Code no longer states that stock in a mutual ditch, reservoir, or irrigation company qualifies for like-kind exchange treatment if it is considered real property under applicable state law.[118] The Joint Explanatory Statement of the Committee of Conference provides that real property eligible for like-kind exchange treatment under old law continues to be eligible for like-kind exchange treatment (this includes stock in a mutual ditch, reservoir, or irrigation company).[119]

Note. The 2018 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 2: Small Business Issues, contains a detailed analysis of like-kind exchanges of real property, including examples.

ENTERTAINMENT, MEALS, AND TRANSPORTATION EXPENSES[120]

Old Law

Generally, employers and other taxpayers may deduct ordinary and necessary business expenses paid for services rendered. This includes fringe benefits paid. Special requirements and limitations apply to several types of fringe benefits, including:

- Entertainment expenses,
- Traveling and commuting benefits, and
- Meals.

Entertainment Expenses.[121] Generally, expenses for entertainment, or for a facility providing entertainment, are deductible only to the extent they are:

1. Directly related to the active conduct of the taxpayer's trade or business, or
2. Associated with the active conduct of the taxpayer's trade or business, and the entertainment immediately precedes or follows a substantial and bona fide business discussion.

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116. Ibid.

117. IRC §§1031(a)(2) and 1031(h) as amended by the TCJA §13303.

118. IRC §§501(c)(12)(A) and 1031(i) prior to being stricken by the TCJA §13303.

119. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20 Statement.pdf] Accessed on Jun. 15, 2018.

120. IRC §§162(a) and 274; TCJA §13304.

121. Treas. Reg. §1.274-2.

For entertainment expenses to be deductible the following substantiation is required.

1. The amount of the expense
2. The time and place of the entertainment
3. The business purpose of the expense
4. The business relationship with the persons entertained

Entertainment comprises amusement and recreation and includes a variety of activities such as the following.

- Night club entertainment
- Cocktail lounges
- Cinema and theaters
- Country clubs
- Golf, athletic clubs, and other sporting events
- Hunting, fishing, vacation, and similar trips

Entertainment may also include food, beverages, a hotel room, or a car used personally or by family members.

Club dues for membership in any club organized for business, pleasure, recreation, or other social purpose are **not** deductible.[122]

The following limitations apply on deductions for tickets to entertainment and sporting events.

1. The tax deduction for seats in a skybox or other luxury box that is leased for more than one event is limited to the sum of the face value of nonluxury box seat tickets for these events.
2. The tax deduction for a ticket to an entertainment event or facility cannot exceed the face value of the ticket (unless it is for a charitable sporting event).[123]

Exceptions to 50% Deductibility Limitation.[124] Generally, only 50% of allowable entertainment expenses are tax deductible. However, a full tax deduction is provided in the following situations.

- Certain entertainment expenses for goods, services, and facilities that are treated as compensation to an employee-recipient
- Expenses for recreational, social, or similar activities and related facilities primarily for the benefit of employees who are not highly compensated
- Expenses for entertainment available to the general public
- Entertainment expenses for goods, services, and facilities that are includable in the gross income of a nonemployee recipient as compensation for services rendered or as a prize or award

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122. IRC §274(a)(3).

123. IRC §274(l) prior to being stricken by the TCJA §13304.

124. IRC §§274(n) and (e).

Employer-Provided Meals. When an employer provides meals to employees and their spouses and dependents for the employer's convenience and on the employer's business premises, the value of the meals is excludable from the employee's income.[125] The employer's deduction for the value of the meals provided is subject to the general rule that limits deductions for food and beverages to 50% of the expense.[126] However, if the meals are considered "de minimis" fringe benefits (so small as to make accounting for them unreasonable or impractical), then they are fully deductible by the employer.[127]An employer-provided eating facility for employees is a de minimis fringe benefit if:

1. The facility is located at or near the employer's business premises, and
2. Revenue derived from the facility normally equals or exceeds its direct operating costs.

De minimis fringe benefits are also excludable from the employee's income.[128]

The following table shows the percentage of certain meals and entertainment that are currently deductible.[129] These deductions were unaffected by the TCJA and therefore continue to apply in 2018 and future years.

Deductible Meal and Entertainment Expenses

Expense	Percent Deductible
Business meals with clients/customers	50%
Business meals with partners/officers/directors	50%
Meals while traveling for business	50%
Employee meals for required business meeting	50%
Yearend party for employees and their families	100%
Meals for general public associated with marketing business	100%

Transportation and Commuting. Generally, personal commuting expenses (between home and work) are nondeductible.[130] However, tax relief is available for qualified employer-provided transportation fringe benefits that are excludable from an employee's income.[131] Qualified transportation fringe benefits include the following.

- Transportation in a commuter highway vehicle (most commonly a van pool) between the employee's residence and workplace
- Transit passes
- Qualified parking
- Qualified bicycle commuting reimbursement

For 2017, employees had a $255 maximum monthly exclusion for highway vehicle transport and transit passes, or for qualified parking benefits.[132] A $20 maximum monthly exclusion was available for bicycle commuting reimbursements.[133]

125. IRC §119(a).
126. IRC §274(n); CCA 201151020 (Dec. 23, 2011).
127. IRC §274(n)(2)(B).
128. IRC §§132(a)(4) and (e).
129. IRC §274.
130. Treas. Regs. §§1.162-2(e) and 1.262-1(b)(5).
131. IRC §132(a)(5).
132. Rev. Proc. 2016-55, 2016-45 IRB 707.
133. IRC §132(f).

New Law

The TCJA made changes to an employer's tax deduction for entertainment, meals, and transportation expenses incurred or paid after December 31, 2017. These changes are summarized in the following table.

Description	Pre-2018 Expenses	Post-2017 Expenses	IRC Section(s)
Entertainment expenses	Generally, 50% deductible if related to active conduct of business	Generally, no deduction for entertainment expenses	IRC §§274(l)(1)(B) and 274(n)(1)(B), as stricken by the TCJA; IRC §274(a)(1) post-TCJA
Meals provided for employees at the convenience of the employer	100% deductible if the meals are considered a de minimis fringe benefit, otherwise 50% deductible	50% deductible (nondeductible after 2025)	IRC §274(n)(2)(B), prior to amendment by the TCJA; IRC §274(o) post-TCJA
Transportation and commuting benefits	• $255 maximum monthly commuting and parking • $20 maximum monthly bicycle commuting	No deduction for transportation and commuting benefits	IRC §132(a)(5) prior to amendment by the TCJA; IRC §274(l) post-TCJA

Entertainment Expenses. Generally, expenses paid or incurred after 2017 for entertainment, or for a facility providing entertainment, are **not** deductible. This is true regardless of whether the expenses are directly related to, or associated with, the active conduct of the taxpayer's trade or business.[134] Based on a strict reading of the statute, business meals with clients are considered "entertainment" and are no longer deductible. However, the following entertainment expenses remain fully deductible.[135]

1. Certain entertainment expenses for goods, services, and facilities that are treated as compensation to an employee-recipient
2. Expenses for recreational, social, or similar activities and related facilities primarily for the benefit of employees who are not highly compensated
3. Expenses for entertainment sold to customers
4. Entertainment expenses for goods, services, and facilities that are includable in the gross income of a non-employee recipient as compensation for services rendered or as a prize or award

Prior law substantiation requirements continue to apply to these deductions, except that the taxpayer does not have to substantiate the time and place of the entertainment.[136]

Employer-Provided Meals. Effective beginning January 1, 2018, employer-provided meals to employees and their spouses and dependents for the employer's convenience and on the employer's business premises are 50% deductible by the employer. This treatment also applies to de minimis meals, which were previously fully deductible.

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134. IRC §274(a)(1) as amended by the TCJA §13304.

135. IRC §§274(e) and (n)(2)(A).

136. IRC §274(d) as amended by the TCJA §13304.

After December 31, 2025, a deduction is not allowed for amounts that an employer pays or incurs for the following.[137]

1. Meals excludable from an employee's income (under IRC §119(a)) because they are provided to employees and their spouses and dependents for the employer's convenience and on the employer's business premises
2. De minimis food, beverage, and facility expenses

> **Note.** The 2018 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 2: Small Business Issues, contains a detailed analysis of entertainment, meals, and transportation expenses, including examples.

CORPORATE ALTERNATIVE MINIMUM TAX

Old Law

For tax years beginning **before** January 1, 2018, the alternative minimum tax (AMT) generally applies to all corporations subject to the regular income tax.[138] For this purpose, the term corporation includes associations, joint-stock companies, and insurance companies.[139]

Certain corporations are exempt from the AMT. These include corporations in their first year of existence and small corporations that meet a gross receipts test.[140]

The AMT is 20% of the corporation's alternative minimum taxable income (AMTI) and is calculated and reported on Form 4626, *Alternative Minimum Tax — Corporations*. Corporate AMT only applies if the corporation's tentative minimum tax (TMT) exceeds the corporation's regular tax liability.[141]

New Law

AMT on corporations is **repealed** effective for tax years beginning after December 31, 2017.[142]

Corporations with a tax year that begins before January 1, 2018, and ends after December 31, 2017, calculate their regular and AMT according to the following steps.[143]

1. Calculate the regular tax for the year using the graduated tax rates in effect prior to the TCJA.[144]
2. Calculate the regular tax for the year using the new 21% rate.[145]
3. Calculate the proportion of each tax amount based on the number of days in the tax year when the different rates were in effect (i.e., pre-January 1, 2018, and post-December 31, 2017).
4. The sum of the two amounts determined in step 3 is the corporation's regular tax for the fiscal year.
5. Calculate the corporation's TMT by applying the 20% rate to corporate AMTI for the period prior to January 1, 2018 (there is no TMT after December 31, 2017, because the zero AMT rate applies).
6. The corporation's AMT for the tax year is the excess, if any, of the corporation's TMT (step 5) over the corporation's regular tax (step 4).

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137. IRC §274(o) as amended by the TCJA §13304.
138. IRC §55(a), prior to amendment by the TCJA §12001(a).
139. IRC §7701(a)(3).
140. IRC §55(e), prior to amendment by the TCJA §12001(b)(6).
141. IRC §55(a), prior to amendment by the TCJA §12001.
142. IRC §55(a) as amended by the TCJA §12001.
143. IRS Notice 2018-38, 2018-18 IRB 522.
144. IRC §11(b), prior to amendment by the TCJA §13001.
145. IRC §11(b), as amended by the TCJA §13001.

CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY OF CORPORATIONS

Old Law[146]

The credit for prior year minimum tax (AMT credit) permits a corporation to reduce its regular tax liability by some or all of the AMT the corporation paid in previous years. The amount of prior year AMT that is taken into account for this purpose is the amount of adjusted net minimum tax for all tax years beginning after 1986, reduced by the minimum tax credit claimed in tax years beginning after 1986. Unutilized AMT credits are carried forward indefinitely until they can be taken as a credit against a future year's regular tax liability.

The maximum amount of AMT credit that can be taken in a year is limited to the extent that the regular tax liability reduced by other nonrefundable credits exceeds the TMT for the tax year. The AMT credit cannot be claimed in any year when the corporation's TMT exceeds its regular tax liability.

The AMT credit is claimed on Form 8827, *Credit for Prior Year Minimum Tax—Corporations*.

A corporation may elect to accelerate the minimum tax credit and obtain a refundable credit in lieu of the special depreciation allowance.[147]

The AMT credit allowable for a tax year is not less than the greater of:

1. 50% of the long-term unused minimum credit for the tax year, or
2. The amount (if any) of the AMT refundable credit amount determined for the taxpayer's preceding tax year.[148]

New Law

In addition to repealing the corporate AMT, the TCJA also modified the credit for prior year corporate minimum tax liabilities (AMT credit).[149]

For tax years beginning after December 31, 2017, a corporation's TMT is zero for purposes of the AMT credit.[150] Consequently, the maximum possible AMT credit is the corporation's regular tax liability, reduced by other nonrefundable credits.

A corporation's unused pre-2018 AMT credits are recovered as refundable credits for tax years beginning in 2018–2021.[151] The refundable credit amount is 50% (100% for tax years beginning in 2021) of the excess of the accumulated AMT credit for the tax year, over the amount allowable for the year against regular tax liability.[152] Thus, the full amount of the accumulated minimum tax credit is recovered in tax years beginning before 2022.

Example 2. As of December 31, 2017, Able Corporation has an accumulated AMT credit of $100,000. In 2018, Able's net regular tax liability (after nonrefundable credits) is $10,000. Therefore, Able's excess AMT credit for 2018 is $90,000 ($100,000 accumulated AMT credit – $10,000 net 2018 tax liability), and $45,000 ($90,000 × 50%) of this credit is refundable in 2018.

Example 3. In 2021, Able Corporation has an $11,250 AMT credit carryover from prior years and a net regular tax liability (after nonrefundable credits) of $5,000. The remaining AMT credit of $6,250 ($11,250 accumulated AMT credit – $5,000 net 2021 tax liability) is claimed as a refundable credit on the 2021 corporate tax return.

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146. IRC §53 prior to amendment by the TCJA §12002.

147. IRC §168(k)(4).

148. Determined without regard to IRC §53(f)(2) (IRC §53(e)(2), prior to being stricken by the TCJA).

149. TCJA §12002; IRC §53.

150. IRC §55(a) as amended by the TCJA §12001.

151. IRC §53(e)(2).

152. Ibid.

CORPORATE TAX RATE CHANGE

Old Law

For tax years beginning before January 1, 2018, corporate income tax rates for corporations are graduated.[153] There are eight rates as shown in the following table.

Taxable Income	Tax Rate
Not over $50,000	15%
Over $50,000 but not over $75,000	25%
Over $75,000 but not over $100,000	34%
Over $100,000 but not over $335,000	39%
Over $335,000 but not over $10,000,000	34%
Over $10,000,000 but not over $15,000,000	35%
Over $15,000,000 but not over $18,333,333	38%
Over $18,333,333	35%

New Law

Effective for tax years beginning after December 31, 2017, the graduated corporate tax rate structure is eliminated and corporate taxable income is taxed at a **flat 21% rate.[154]** This flat tax rate also applies to personal service corporations.[155]

> **Note.** The 2018 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 4: C Corporations, contains a discussion of the corporate tax rate changes for fiscal year corporate taxpayers.

REDUCTION IN DIVIDEND RECEIVED DEDUCTIONS

Old Law

A corporation is entitled to a special deduction for dividends received from a domestic corporation that is subject to income tax. This deduction is known as a **dividends-received deduction (DRD).** For tax years beginning before 2018, the amount of the DRD is generally equal to 70% of the dividend received, or 80% of the dividend received from a 20%-owned corporation.[156]

New Law

Effective for tax years beginning after December 31, 2017, the DRD is 50% of dividends received if the corporation receiving the dividend owns less than 20% of the distributing corporation.[157] The DRD increases to 65% of dividends received if the receiving corporation owns 20% or more of the stock of the distributing corporation.[158]

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153. IRC §11(b), prior to amendment by the TCJA§13001; *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018.

154. IRC §11(b).

155. IRC §11(b) as amended by the TCJA §13001; *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018.

156. IRC §§243(a)(1) and (c)(1), prior to amendment by the TCJA §13002.

157. IRC §243(a)(1) as amended by the TCJA §13002.

158. IRC §243(c)(1) as amended by the TCJA §13002.

A 20%-owned corporation is an issuing corporation if 20% or more of its stock, by vote and value, is owned by the receiving corporation.[159]

> **Note.** For tax years beginning after 2017, the DRD is reduced to reflect the lower 21% flat corporate tax rate[160] that applies to such tax years. Consequently, dividends subject to the 50% DRD are taxed at a maximum rate of 10.5% (21% corporate tax rate × 50%). Dividends subject to the 65% DRD are taxed at a maximum rate of 7.35% (21% corporate tax rate × 35%).

A small business investment company operating under the Small Business Investment Act of 1958[161] is allowed a 100% DRD for dividends received from a taxable domestic corporation.[162] A corporation that is a member of an affiliated group is generally also entitled to a 100% DRD for dividends received from other members of the group.[163]

SMALL BUSINESS ACCOUNTING METHOD SIMPLIFICATION[164]

Old Law

Accounting Methods. Taxpayers are required to use accounting methods that clearly reflect income and to apply them consistently.[165] Available accounting methods include:[166]

- The cash method,
- The accrual method,
- Allowable special methods (e.g., long-term contract method), or
- A hybrid method that combines any of the above methods.

Taxpayers using the cash method report their income in the year received, whether it is in the form of cash, property, or services with a determinable value. Deductions and credits are accounted for in the year when the expenses are paid, unless a special rule requires the expenses to be taken in a different year to clearly reflect income.[167]

Generally, the following entities **cannot** use the cash method.[168]

1. C corporations
2. Partnerships with one or more C corporations as a partner or partners
3. Tax shelters
4. Certain trusts subject to tax on unrelated business income
5. Farming syndicates[169]

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159. IRC §243(c)(2) as amended by the TCJA §13002.
160. IRC §11(b) as amended by the TCJA.
161. PL 85-699.
162. IRC §243(a)(2).
163. IRC §§243(a)(3) and (b).
164. TCJA §13102.
165. IRC §446(b).
166. IRC §446(c).
167. Treas. Reg. §1.446-1(c)(1)(i).
168. IRC §§448(a) and (d)(6).
169. IRC §464.

However, the cash method of accounting is available in the following circumstances.

- A sole proprietorship, partnership, and S or C corporation with average revenue for the last three years of less than $1 million[170]
- A corporation or partnership, other than a tax shelter, that has average annual gross receipts of $5 million or less for each tax year beginning after 1985 (Average annual gross receipts for a tax year are gross receipts for that tax year and the two preceding tax years divided by three.)[171]
- Large family-owned C corporations that meet a $25 million gross receipts test[172]

Inventory Accounting. When the purchase, production, or sale of merchandise is an income-producing factor, taxpayers must keep inventories and use the accrual method of accounting for inventory items.[173]

Generally, businesses with inventories must use the accrual method. However, certain small businesses do not need to account for inventories and can use the cash method instead. To qualify for this exception, the business must have average annual gross receipts of $1 million or less, or be engaged in certain specified trades or businesses and have average annual gross receipts of $10 million or less.[174]

Treatment of Materials and Supplies. Under Treas. Reg. §1.162-3, materials and supplies may be treated in various ways, depending on whether the materials and supplies are incidental or nonincidental. **Incidental items** are those for which no record of consumption is kept or no physical inventories are taken at the beginning and end of the year (e.g., basic office supplies). **Nonincidental items** are those for which a record of consumption or inventory is kept and can include items such as spare parts and inventory items for small businesses.

The cost of acquiring incidental items is deductible in the tax year in which these amounts are paid or incurred, as long as the deductions clearly reflect income. The cost of acquiring or producing nonincidental items may or may not be currently deductible. A taxpayer has four choices on how to handle the cost.

1. Defer a deduction until the items are consumed.
2. Elect to capitalize the cost and depreciate the items. This option applies to such items as rotable spare parts, temporary spare parts, and emergency spare parts.[175] The election is made on a timely filed income tax return so that a depreciation allowance can be claimed starting for the year in which the parts are placed in service.
3. Under an optional method of accounting for rotable and temporary (but not emergency) spare parts, the cost is deducted when the parts are first installed.
4. Elect to apply a de minimis rule that permits a current deduction up to a set dollar limit per invoice.

Uniform Capitalization Rules. Generally, businesses that produce real or tangible personal property or acquire property for resale must use the uniform capitalization (UNICAP) rules. This requires them to include the direct costs and a portion of the allocable indirect costs of producing or acquiring property in their inventory costs.[176]

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170. Rev. Proc. 2000-22, 2000-20 IRB 1008.

171. IRS Pub. 538, *Accounting Periods and Methods*.

172. IRC §447(d)(2), prior to being stricken by TCJA §13102(a)(5)(C)(i).

173. Treas. Regs. §§1.446-1(c)(2) and 1.471-1.

174. Rev. Procs. 2001-10, 2001-1 CB 272 and 2002-28, 2002-1 CB 815.

175. See Treas. Reg. §1.162-3 for the definitions of such parts.

176. IRC §263A.

Businesses may qualify for an exception to the UNICAP rules for personal property purchased for resale if the business has average annual gross receipts of $10 million or less for the preceding three tax years.[177] Other exceptions from the UNICAP rules include costs for:

- Raising, harvesting, or growing trees;[178]
- Costs of producing animals or producing plants with a preproductive period of two years or less (unless use of the accrual method is required);[179]and
- Qualified creative expenses of freelance authors, photographers, and artists.[180]

Long-Term Construction Contracts. Generally, long-term contracts should be accounted for using the percentage of completion method of accounting.[181] Under this method, taxpayers recognize income from the contract as the contract is completed. Therefore, income for a year is equal to the percentage of the contract completed in the year multiplied by the gross contract price. The percentage of the contract completed is determined by dividing the costs allocated to the contract and incurred before the end of the tax year by the estimated total contract costs.[182]

Exceptions to the mandatory use of the percentage of completion method apply to:

- Small construction contracts,[183]
- Home construction contracts,[184] and
- Residential construction contracts.[185]

For purposes of the exception, a small construction contract is any contract for the construction or improvement of real property that meets both of the following conditions.[186]

1. Expected to be completed within the 2-year period beginning on the contract's commencement date
2. Performed by a taxpayer whose average annual gross receipts for the three tax years preceding the tax year in which the contract is entered into does not exceed $10 million

Besides the percentage of completion method, taxpayers have the option of reporting income from small construction contracts under the completed contract method, the exempt-contract percentage of completion method, or any other permissible method.[187]

New Law

The TCJA contains the following provisions that simplify accounting requirements for small businesses.

- Increased availability of the cash method of accounting
- Expansion of exceptions to required use of inventories
- Expansion of exceptions to UNICAP rules
- Expansion of exceptions to use of the percentage of completion method for small construction contracts

177. IRC §263A(b)(2), prior to amendment by TCJA §13102(b)(2).
178. IRC §263A(c)(5).
179. IRC §263A(d)(1).
180. IRC §263A(h).
181. IRC §460(a).
182. IRC §460(b).
183. IRC §460(e)(1)(B).
184. IRC §460(e)(1)(A).
185. IRC §460(e)(4).
186. IRC §460(e)(1)(B), prior to amendment by TCJA §§13102(d)(1)(A)-(B).
187. Treas. Reg. §1.460-4(c)(1).

Gross Receipts Test. Effective for tax years beginning after December 31, 2017, the TCJA introduces a single $25 million gross receipts test for determining whether activities qualify as small businesses.[188] Taxpayers meeting this test can use the cash method of accounting, are not required to keep inventories, are not required to apply the UNICAP rules, and are not required to use the percentage of completion method for small construction contracts.

Previously, there were several gross receipts thresholds ranging from $1 million to $25 million for classifying activities as small businesses for these purposes. The adoption of a single $25 million gross receipts test both simplifies gross receipts determinations and increases the number of activities qualifying as small businesses.

Consequently, a C corporation or a partnership with a C corporation partner that meets the $25 million gross receipts test can qualify to use the cash method of accounting.[189]

The $25 million gross receipts test is satisfied for a tax year if average annual gross receipts of the business for the 3-tax-year period that ends with the tax year preceding such tax year do not exceed $25 million.[190] The $25 million threshold is adjusted for inflation for tax years beginning after December 31, 2018.[191]

Example 4. Bellflower Corporation wants to use the cash accounting method in 2018.

Bellflower had the following gross receipts in the three preceding tax years.

Tax Year	Gross Receipts
2017	$23 million
2016	30 million
2015	16 million

Average annual gross receipts for the 3-tax-year period are $23 million (($16 million + $30 million + $23 million) ÷ 3).

Because the $23 million of average annual gross receipts for the 3-tax-year period is less than $25 million, Bellflower meets the gross receipts test and may use cash accounting for 2018.

Exceptions to the Gross Receipts Test. Qualified personal service corporations, partnerships without C corporation partners, S corporations, and other pass-through entities can continue to adopt the cash method of accounting regardless of whether they meet the $25 million gross receipts test if the cash method clearly reflects income and the entity is not a tax shelter.[192]

Expansion of Exceptions to Required Use of Inventories. Effective for tax years beginning after December 31, 2017, a business is not required to use inventories if it meets the $25 million gross receipts test (as previously defined).[193] For this purpose, individual taxpayers apply the gross receipts test as if **each** trade or business of the taxpayer were a corporation or a partnership.[194] Therefore, in the case of a business organized as a single-member LLC (SMLLC), the $25 million gross receipts test is the same as that used by a corporation or partnership.[195]

188. TCJA §13102(a) and IRC §448(c)(1) as amended by the TCJA §13102.

189. IRC §448(b)(3).

190. IRC §448(c)(1) as amended by the TCJA §13102.

191. IRC §448(c)(4) as amended by the TCJA §13102.

192. PL 115-97 (Dec. 22, 2017); *Joint Explanatory Statement of the Committee of Conference* (p. 220). [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on Jun. 16, 2018.

193. IRC §471(c)(1) as amended by the TCJA §13102.

194. IRC §471(c)(3) as amended by the TCJA §13102.

195. Ibid.

Businesses meeting the $25 million gross receipts test can use a method of accounting for inventory that either treats inventory as nonincidental materials and supplies or conforms to the business's financial accounting treatment of inventories.[196] There is no change to the treatment of incidental and nonincidental materials and supplies (see "old law" section).

When utilization of the exception to the required use of inventories results in an accounting method change, this change is considered initiated by the taxpayer and made with the IRS's consent for purposes of any IRC §481 adjustment.[197] The accounting method change is made by filing Form 3115, *Change in Accounting Method,* and following the IRS procedures for accounting method changes.[198] This change is automatic and does not require payment of a user fee.

Expansion of Exceptions to UNICAP Rules. Effective for tax years beginning after December 31, 2017, a taxpayer who meets the $25 million gross receipts test is not required to apply the UNICAP rules for the tax year.[199] This expansion of the exceptions to the UNICAP rules applies to any producer or reseller, other than a tax shelter, meeting the $25 million gross receipts test.[200]

For this purpose, taxpayers should apply the gross receipts test as if **each** trade or business of the taxpayer were a corporation or a partnership. Therefore, in the case of a business organized as an SMLLC, the $25 million gross receipts test is the same as that used by a corporation or partnership.[201]

> **Note.** A taxpayer making a change to the overall cash method, a change to capitalize costs under §263A, and/or a change from the use of inventories may file a single Form 3115 for all changes, provided the taxpayer enters the designated automatic accounting method change numbers on the appropriate line of Form 3115. See Rev. Proc. 2018-40 for more information.

Expansion of Small Construction Contract Exception. For long-term construction contracts entered into after December 31, 2017,[202] the exception to the required use of the percentage of completion method applies to contracts entered into by a taxpayer who meets both of the following requirements.[203]

1. Estimates at the time of the contract indicate that it will be completed within the 2-year period beginning on the contract commencement date
2. Meets the $25 million gross receipts test in the tax year in which the contract is entered into

For this purpose, taxpayers should apply the gross receipts test as if **each** trade or business of the taxpayer were a corporation or a partnership.[204] Therefore, in the case of a business organized as an SMLLC, the $25 million gross receipts test is the same as that used by a corporation or partnership.

When a taxpayer changes its method of accounting based on the small construction contract exception, this change is considered initiated by the taxpayer, made with the IRS's consent, and made on a cut-off basis for all similarly classified contracts entered into on or after the year of change.[205] This accounting method change is made by filing Form 3115 and following the IRS procedures for accounting method changes.[206]

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196. IRC §471(c)(1)(B) as amended by the TCJA §13102.
197. IRC §471(c)(4) as amended by the TCJA §13102.
198. Rev. Procs. 2015-13, 2015-5 IRB 419 and 2017-30, 2017-17 IRB 18.
199. IRC §263A(i)(1) as amended by the TCJA §13102.
200. Ibid.
201. IRC §263A(i)(2) as amended by the TCJA §13102.
202. TCJA §§13102(d)(1)(A)-(B).
203. IRC §460(e)(1)(B) as amended by the TCJA §13102.
204. IRC §460(e)(2)(A) as amended by the TCJA §13102.
205. IRC §460(e)(2)(B) as amended by the TCJA §13102.
206. Rev. Procs. 2015-13, 2015-5 IRB 419 and 2017-30, 2017-17 IRB 18.

NET OPERATING LOSSES[207]

Old Law

A net operating loss (NOL) arises when a taxpayer's business deductions exceed its gross income. An NOL is carried back two years and then carried forward 20 years to offset taxable income in those years. Extended carryback periods apply to the following types of NOLs.

- Three years for small businesses or taxpayers engaged in farming if the NOL is attributable to a federally declared disaster[208]
- Five years for NOL from farming activities[209]
- 10 years for a specified liability loss[210]

Farming Losses. A farming NOL is the smaller of:

1. The NOL applicable for the tax year if only income and deductions attributable to farming businesses are considered, or
2. The NOL for the tax year.

When a taxpayer elects to waive the 5-year carryback for a farming NOL, the 2-year carryback period generally applies.

Specified Liability Loss. A specified liability loss is the portion of an NOL pertaining to product liability or to a federal or state mandate requiring:[211]

- Land reclamation,
- Nuclear power plant decommissioning,
- Drilling platform dismantling,
- Environmental remediation, or
- A workers' compensation payment.

REITs.[212] There is no carryback period for NOLs of REITs. Instead, they are carried forward 20 years.

Corporate Equity Reduction Interest Loss (CERT). When $1 million or more of interest expense is incurred in a "major stock acquisition" of another corporation by a C corporation or in an "excess distribution," that C corporation may not carry back a portion of its related NOL.[213] The amount of the NOL subject to this limitation is the lesser of:

1. The corporation's deductible interest expense allocable to the CERT, or
2. The amount by which the corporation's interest expense for the current tax year exceeds the average interest expense for the three tax years preceding the tax year in which the CERT occurs.

NOL Computation. Corporate and noncorporate taxpayers must make various modifications to taxable income when determining the NOL for a tax year (e.g., the DPAD is not allowed).[214]

207. TCJA §13302 and IRC §172.
208. IRC §§172(b)(1)(E)(ii)(II) and (III) prior to being stricken by the TCJA §13302.
209. IRC §§172(b)(1)(F) and (h) prior to being stricken by the TCJA §13302.
210. IRC §§172(b)(1)(C) prior to amendment by the TCJA §13302 and (f) prior to being stricken by the TCJA §13302.
211. IRC §172(f)(1)(B)(i) prior to being stricken by the TCJA §13302.
212. IRC §172(b)(1)(B) prior to amendment by the TCJA §13302.
213. IRC §§172(b)(1)(D) and (g) prior to being stricken by the TCJA §13302.
214. IRC §172(d) prior to amendment by the TCJA §13302.

New Law

The main changes to NOLs made by the TCJA are summarized in the following table.[215]

TCJA Provision	Effective Date
NOLs may only reduce 80% of taxable income in carryback and carryforward years	Tax years **beginning** after 2017
An unlimited carryforward period is provided	Tax years **ending** after 2017
NOL carrybacks are generally eliminated	Tax years **ending** after 2017

2017–2018 Fiscal Year Filers. There are two important considerations for 2017-2018 fiscal year filers.

1. A 2017–2018 fiscal-year NOL may **not** be carried back two years because it arose in a tax year ending after 2017.
2. A 2017–2018 fiscal-year NOL is **not** subject to the 80% of taxable income limitation because the NOL did not arise in a tax year beginning after 2017.

80% of Taxable Income Limitation. Effective for NOLs arising in tax years beginning after December 31, 2017, the NOL deduction is limited to the **lesser** of:

- The aggregate of NOL carryforwards and carrybacks to the tax year, or
- 80% of taxable income computed for the tax year without regard to the NOL deduction allowed for the tax year.[216]

When applying the 80% taxable income limitation to a REIT, the REIT's taxable income does not include the dividends paid deduction.[217]

Carryback and Carryforward Rule Changes.[218] Effective for tax years **ending** after 2017, NOL carrybacks are generally eliminated, except for NOLs attributable to farming losses and certain insurance companies (discussed later). The 20-year limitation on carryforwards is also eliminated. Henceforth, NOLs from tax years **ending** after December 31, 2017, may be carried forward indefinitely. The special carryback rules that applied to the following were eliminated.

- REITs[219]
- Specified liability losses[220]
- CERT limitations on carryback of excess interest losses[221]
- Certain casualty and disaster losses of small businesses and farmers[222]
- Farming losses[223]

215. TCJA §13302.
216. IRC §172(a) as amended by the TCJA §13302.
217. IRC §§857(b)(2) and 172(d)(6)(C) as amended by the TCJA §13302.
218. IRC §172(b) as amended by the TCJA §13302.
219. IRC §172(b)(1)(B) prior to amendment by the TCJA §13302.
220. IRC §172(b)(1)(C) prior to amendment by the TCJA §13302.
221. IRC §172(b)(1)(D) prior to being stricken by the TCJA §13302.
222. IRC §172(b)(1)(E) prior to being stricken by the TCJA §13302.
223. IRC §172(b)(1)(F) prior to being stricken by the TCJA §13302.

Carryback for Farming Losses.[224] Effective for NOLs arising in tax years ending after December 31, 2017, the optional 5-year carryback period for farming losses is reduced to two years.

The option to waive the carryback period for farming losses is unaffected by the TCJA. In addition, the existing rules continue to apply when an NOL for a tax year consists of both a farming loss and a nonfarming loss. The two losses are treated separately, with the farming loss considered in carryback and carryforward years **after** the nonfarming loss.

Casualty and Property Insurance Company Losses.[225] The TCJA preserves the 2-year carryback and 20-year carryforward periods for NOLs of non-life insurance companies (e.g., property and casualty insurance companies). Non-life insurance companies are also exempted from the 80% taxable income limitation. The TCJA also defines the deductible amount of a non-life insurance company's NOL for a tax year as the sum of the NOL carryforwards and NOL carrybacks to the tax year.[226]

NOL Computation. Effective for tax years beginning after December 31, 2017, a taxpayer's NOL for the tax year is based on taxable income.[227] However, the following deductions are not allowed.

- The 20% qualified business income deduction under IRC §199A
- The IRC §250 deduction for foreign-derived intangible income

Due to its repeal by the TCJA, the IRC §199 DPAD no longer affects the calculation of NOLs in tax years beginning after 2017.[228]

> **Note.** The 2018 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 2: Individual Taxpayer Issues, addresses the changes in the treatment of NOLs for individual taxpayers.

TAX CREDIT CHANGES

Orphan Drug Credit[229]

Old Law. Taxpayers developing drugs to diagnose, treat, or prevent qualified rare diseases and conditions (i.e., those affecting less than 200,000 persons in the United States) can claim a nonrefundable tax credit. The amount of the credit is equal to 50% of qualified clinical testing expenses incurred or paid during the development process under §526 of the Federal Food, Drug, and Cosmetic Act. This credit is part of the general business credit and is therefore subject to the limitations that apply to the general business credit (e.g., the carryback and carryforward rules).[230]

Expenses used to claim the orphan drug tax credit cannot also be used to claim other tax credits or deductions. When qualified clinical testing expenses exceed the amount of the allowable orphan drug tax credit, a tax deduction cannot be claimed for the excess expenses.[231] Moreover, the excess expenses cannot be charged to the capital account.[232]

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224. IRC §172(b)(1)(B) as amended by the TCJA §13302.
225. IRC §172(b)(1)(C) as amended by the TCJA §13302.
226. IRC §172(f) as amended by the TCJA §13302.
227. IRC §172(d) as amended by the TCJA.
228. IRC §172(d)(7) prior to being stricken by the TCJA §13305.
229. IRC §45C prior to amendment by the TCJA §13401.
230. IRC §38(b)(12).
231. IRC §280C(b).
232. Ibid.

New Law.[233] Effective for tax years beginning after December 31, 2017, the amount of the orphan drug credit is reduced to 25% of qualified clinical testing expenses. Alternatively, a taxpayer may elect a reduced credit amount instead of reducing otherwise allowable deductions. When this election is made, the amount of the credit is equal to the excess of:

1. The amount of the credit that is otherwise allowable, over
2. The product of the credit amount (determined in step 1) and the maximum corporation tax rate.

Example 5. Beta Testing Corp., a calendar-year taxpayer, has $10,000 of qualified clinical testing expenses and elects the reduced orphan drug tax credit.

Beta Testing can claim an orphan drug tax credit of $1,975, which is calculated as follows.

1. $10,000 qualified expenses × 25% = $2,500, minus
2. $2,500 × 21% corporate tax rate.

In addition, Beta Testing can claim a deduction of $8,025 ($10,000 qualifying expenses − $1,975 credit) for the excess expenses.

The reduced credit election for any tax year must be made no later than the filing due date of the taxpayer's return for that year (including extensions). Once made, the election is irrevocable.

Rehabilitation Credit Limited to Certified Historic Structures[234]

Old Law. The rehabilitation credit is the sum of:

- 10% of certain qualified rehabilitation expenditures (QREs) for qualified rehabilitated buildings other than certified historic structures, and
- 20% of the qualified rehabilitation expenditures for certified historic structures.

A "qualified rehabilitated building" is defined as any building (and its structural components) that was substantially rehabilitated and placed in service before the beginning of the rehabilitation. Moreover, depreciation must be allowable. Buildings that are not certified historic structures must have been placed in service before 1936. The building must also satisfy a wall-retention test.[235]

New Law.[236] The rehabilitation credit can only be claimed for QREs with respect to qualified rehabilitated buildings that are certified historic structures. In addition, the credit is now claimed ratably over a 5-year period beginning in the tax year in which the rehabilitated building is placed in service.

These modifications are effective for amounts paid or incurred after December 31, 2017, subject to a transition rule.

Employer Credit for Paid Family and Medical Leave[237]

Old Law. There is no similar provision in prior tax law.

New Law. For wages paid in tax years **beginning after December 31, 2017, and before January 1, 2020,** eligible employers can claim a **new general business credit.** This credit provides a tax benefit for employers providing paid leave to their employees under the Family and Medical Leave Act (FMLA).

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233. TCJA §13401.

234. IRC §47.

235. IRC §47(c)(1) prior to amendment by the TCJA §13402.

236. TCJA §13402.

237. TCJA §13403 and IRC §45S.

An employer claiming this credit must reduce its deduction for wages or salaries paid or incurred by the amount of this credit.[238] **Also, wages taken into consideration for any other general business credit are ineligible for this credit.[239]**

Eligible Employer.[240] An eligible employer is one that has a written policy allowing all qualifying full-time employees not less than two weeks of annual paid family and medical leave. Moreover, the employer must also allow all part-time qualifying employees to take a commensurate amount of leave on a pro rata basis. State or local governments are not considered eligible employers for this credit.

Qualifying Employee.[241] A qualifying employee means any employee defined in §203(e) of the Fair Labor Standards Act of 1938 who was employed by the employer for one year or more, and whose compensation in the preceding year does not exceed 60% of the threshold for highly compensated employees. Generally, all such employees are qualifying employees except for immediate family members of agricultural employers and certain public agency volunteers.

Paid Leave Defined.[242] Family and medical leave is defined as leave described under §§102(a)(1)(a)-(e) or 102(a)(3) of the Family and Medical Leave Act of 1993. An eligible employee is entitled to FMLA leave under the following circumstances.

- The birth of a child of the employee and to care for such child
- The placement of a child for adoption or foster care
- A serious health condition of a spouse, child, or parent requiring the employee to care for such person
- The employee's serious health condition that makes the employee unable to perform the functions of the employee's position
- Any "qualifying exigency" arising out of the fact that the employee's spouse, child, or parent is a military member on covered active duty or call to covered active duty status
- To care for a covered service member with a serious injury or illness

Employer-provided paid leave for vacation, personal reasons, or other medical or sick leave is excluded.

Calculating the Credit.[243] The amount of the FMLA credit is 12.5% of wages paid to qualifying employees during any period in which such employees are on family and medical leave if the compensation rate is 50% of the wages normally paid to the employee.

When the rate of payment exceeds 50%, the credit is increased by 0.25% (but not above 25%) for each percentage point by which the rate of payment exceeds 50%. For the purposes of this credit, the maximum amount of family and medical leave that can be considered per employee is 12 weeks for any tax year.

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238. *Section 45S Employer Credit for Paid Family and Medical Leave FAQs*. May 22, 2018. IRS [www.irs.gov/newsroom/section-45s-employer-credit-for-paid-family-and-medical-leave-faqs] Accessed on Jul. 30, 2018.

239. Ibid.

240. IRC §45S(c).

241. IRC §45S(d).

242. IRC §45S(e).

243. IRC §§45S(a) and (b).

Example 6. Abbie is a qualifying employee of Seneca Enterprises LLC, which is an eligible employer for the purposes of the family and medical leave credit. Abbie receives a weekly salary of $1,000. In January and February 2018, she was on a 6-week medical leave, and Seneca Enterprises paid her 75% of her salary.

The amount of the credit that Seneca Enterprises can claim depends on the applicable percentage, which is 12.5% increased by 0.25% for each percentage point by which the rate of payment exceeds 50% of normal compensation. In this case, the applicable percentage is 18.75%, which is determined as follows.

Applicable % = 12.5% + ((75% − 50%) × 0.25%) = 12.5% + 6.25% = 18.75%

Consequently, Seneca Enterprises can claim a 2018 family and medical leave credit of $844 for Abbie's paid medical leave ($750 actual salary × 6 weeks × 18.75% = $844).

Example 7. Use the same facts as **Example 6,** except Abbie is also on a 10-week paid family leave in the fall of 2018, when Seneca Enterprises pays her 50% of her salary. Because the rate of payment did not exceed 50%, the applicable percentage is 12.5%.

For 2018, the family and medical leave credit is limited to a maximum of 12 weeks of employee leave. Therefore, Seneca Enterprises can claim a 2018 credit of $1,219 for Abbie's paid medical and family leave, which is calculated as follows.

$750 actual salary × 6 weeks × 18.75%	$ 844
$500 actual salary × 6 weeks × 12.5%	375
Total FMLA credit	$1,219

Election.[244] A taxpayer **may elect not to claim** the FMLA credit for any tax year (for example, they may prefer to use the applicable wages to claim another general business credit). This election can be made or revoked at any time within three years of the original filing due date of the tax return.

Opportunity Zones

Old Law.[245] A credit is allowed to a taxpayer who makes a qualified equity investment in a qualified community development entity (CDE). The CDE must invest in a qualified active low-income community business.

New Law.[246] Under the TCJA, an option is created for taxpayers who sell property at a gain to roll over the gain into a qualified opportunity zone fund (QOZF).

> **Note.** A list of all of the U.S. counties that qualify to establish a QOZF can be found at **uofi.tax/18b1x1** [www.irs.gov/pub/irs-drop/n-18-48.pdf].

If the taxpayer sells property at a gain and then invests the gain in a QOZF, the tax on any appreciation is deferred or partially eliminated if the taxpayer holds the investment for at least five years. The tax on the appreciation is entirely eliminated if the taxpayer holds the investment for at least 10 years. The advantage over an IRC §1031 like-kind exchange is that the taxpayer only needs to reinvest the amount of the gain rather than the total amount of the sale.

To be able to invest in a QOZF, the taxpayer must do the following.

- Sell property for a capital gain.
- Sell the property to an unrelated party.
- Reinvest the gain in a QOZF within 180 days.

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244. IRC §45S(h).

245. Ibid.

246. IRC §§1400Z-1 and 1400Z-2.

In addition, the QOZF must invest at least 90% of its funds in business property in any qualified zone.

Example 8. Barry has a commercial building that he bought for $1 million, which he sells for $2 million. Under IRC §1031, Barry would have to purchase replacement property worth $2 million to defer the gain. By utilizing a QOZF, Barry only needs to spend $1 million and can use the other $1 million from the sale for any purpose.

Note. A QOZF restricts the investments to lower-income areas. It is unknown at the present time what the fees will be on a QOZF investment. Until that question is answered, it is difficult to evaluate whether a QOZF investment makes economic sense. What is certain, however, is that a taxpayer investing in a QOZF gives up control over the asset that is invested in the QOZF.

REPEAL OF TECHNICAL TERMINATION OF PARTNERSHIPS

Old Law

A partnership is considered terminated if:[247]

- No part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners; or
- Within a 12-month period, there is a sale or exchange of 50% or more of the total interest in partnership capital and profits (this is often termed a "technical termination).

A **technical termination** causes two deemed transfers.[248]

1. The terminated partnership is deemed to contribute all its assets and liabilities to a new partnership in exchange for an interest in the new partnership.
2. Immediately afterwards, in a liquidating distribution, the terminated partnership is deemed to distribute its interests in the new partnership to the purchasing partner and the remaining partners.

Generally, no gain or loss is recognized either by the partnership or the remaining partners on the deemed contribution to the new partnership and the subsequent deemed liquidating distribution.[249]

The following tax consequences result from the technical termination of a partnership.

- The terminated partnership's tax year closes on the date of the sale or exchange that triggers the termination. Consequently, the partnership's final tax return may be for a short year.[250]
- The new partnership must file new tax elections for accounting methods, depreciation methods, installment sales, and amortization and depletion.[251]
- Generally, partnership depreciation recovery periods restart.[252]
- The new partnership must make new IRC §754 optional basis adjustment elections.[253]

Therefore, the main consequences of a technical termination are the termination of some of the partnership's tax attributes.

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247. IRC §708(b) prior to amendment by the TCJA §13504.

248. Treas. Reg. §1.708-1(b)(4).

249. IRC §§721 and 731.

250. Treas. Reg. §1.708-1(b)(3).

251. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018.

252. Ibid.

253. Notice of Proposed Rulemaking PS-5-96, Preamble.

New Law[254]

The TCJA repeals the technical termination of partnerships provision for partnership tax years beginning after December 31, 2017.

The repeal of the technical termination provision has the following tax consequences.

- Continued use of existing depreciation methods and remaining useful lives for partnership assets
- No risk of late filed **final** partnership returns because the tax advisor was unaware that a termination had occurred until the filing due date had passed
- The partnership's new owners must abide by existing partnership elections and accounting methods

DEDUCTION FOR FINES AND PENALTIES[255]

Old Law[256]

The Code disallows deductions for certain business expenses that would otherwise be allowed. Penalties and fines are generally not deductible.[257] Whether this treatment applies to both punitive and remedial fines and penalties is unclear in the Code. However, according to the IRS, the tax deduction prohibition stated in IRC §162(f) only applies to punitive fines and penalties.[258] Consequently, those fines and penalties that are remedial in nature may be deducted as business expenses.

Prior to enactment of the TCJA, the Code disallowed tax deductions for fines and penalties paid to:

- The U.S. federal government, a state, a territory or possession of the United States, the District of Columbia, or the Commonwealth of Puerto Rico;
- The government of a foreign country; or
- A political subdivision of any of these governments or any corporation or other entity serving as an agency or instrumentality of these governments.

> **Note.** A government of a foreign country includes a government of two or more foreign countries. Thus, fines imposed by the Commission of the European Community on behalf of member countries of the European Union falls under the prohibition.

Tax deductions are also disallowed for the following fines and penalties.

- Paid pursuant to a conviction, a guilty plea, or a plea of no contest for a crime (felony or misdemeanor) in a criminal proceeding
- Imposed by federal, state, or local law, including additions to tax and penalties
- Paid in settlement of a taxpayer's actual or potential liability for a fine or penalty (civil or criminal)
- Amounts forfeited as collateral posted in a proceeding that could result in the imposition of a fine or a penalty
- A civil penalty imposed to punish a violation of the law[259]

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254. TCJA §13504 and IRC §708(b)(1) as amended by the TCJA §13504.
255. TCJA §13306.
256. Treas. Reg. §1.162-21.
257. IRC §162(f) prior to amendment by the TCJA §13306.
258. TAM 200502041 (Jan. 14, 2005).
259. *Southern Pacific Transportation Company v. Comm'r*, 75 TC 497 (1980).

- A restitution ordered after a criminal conviction[260]
- Payments to the Environmental Protection Agency (EPA) to settle a civil action under the environmental protection laws[261]

However, the following payments are not considered punitive and are therefore tax deductible.

- A civil penalty imposed to encourage compliance or as compensation for expenses resulting from the violation[262]
- Penalties imposed under the Federal Water Pollution Control Act[263]
- Payments pursuant to a settlement agreement under the Anti-Dumping Act of 1921[264]
- Payments under Section 16(b) of the Securities Exchange Act[265]
- A nonconformance penalty assessed by the EPA, designed to eliminate the competitive advantage of failing to comply with certain requirements[266]

Fines and penalties do not include legal fees and court costs paid or incurred in a proceeding that resulted (or could result) in the imposition of a fine or penalty.

Payments made to the government under the multiple damage provisions of the False Claims Act (FCA) may be either remedial or punitive. The intent of the parties determines if a lump-sum settlement payment under the FCA is for remedial purposes (tax deductible) or punitive purposes (nondeductible).[267]

Fines and penalties, nondeductible under IRC §162(f), cannot instead be treated as charitable contributions, even if they are made to an organization that can accept deductible contributions.[268]

New Law[269]

Effective for orders and agreements made beginning on **December 22, 2017,** the new law states that tax deductions are generally not allowed for fines, penalties, and other payments made to governments or governmental entities pertaining to law violations **except for the following** payments.

- Restitution (including the remediation of property) for damages due or that may be due to the violation (or potential violation) of a law
- Payments to come into compliance with a violated law, or the investigation or inquiry into the violation or potential violation of a law
- Satisfaction of a court order when the government is not a party
- Taxes due

260. *Harvey Waldman v. Comm'r*, 850 F.2d 611 (9th Cir. 1988), *aff'g* 88 TC 1384.
261. *Colt Industries, Inc. v. U.S.*, 880 F.2d 1311 (Fed. Cir. 1989).
262. *Middle Atlantic Distributors, Inc. v. Comm'r*, 72 TC 1136, 1143 (1979).
263. *H.A. True, Jr. and Jean D. True v. U.S.*, 603 F.Supp.1370 (Dist. Wyo. 1985).
264. Ltr. Rul. 8704003 (Oct. 3, 1986).
265. *Laurence M. Marks and Marjorie G. Marks v. Comm'r*, 27 TC 464 (1956).
266. Rev. Rul. 88-46, 1988-1 CB 76.
267. *Talley Industries, Inc. v. Comm'r*, 116 F.3d 382 (9th Cir. 1997).
268. Rev. Rul. 79-148, 1979-1 CB 93.
269. IRC §162(f) as amended by TCJA §13306.

For restitution or compliance payments to be deductible, the taxpayer must establish that the payment:

1. Constitutes restitution (including remediation of property) for damage or harm which was or may be caused by the violation of any law or the potential violation of any law, or

2. Was made to comply with any law which was violated or otherwise involved in the investigation or inquiry.

Furthermore, the payment must satisfy the following conditions.

1. It must be identified as restitution or as an amount paid to come into compliance with the court order or settlement agreement.

2. When the payment constitutes restitution for the failure to pay taxes, a tax deduction would have been allowable if the payment had been timely paid.

Until proposed regulations are issued, the identification requirement is satisfied if the settlement agreement or court order specifically states that the amount is restitution, remediation, or for coming into compliance with the law.[270]

Nongovernment Entities. The following nongovernment entities are treated as governmental entities for fines and penalties imposed.

- Any nongovernmental entity that exercises self-regulatory powers (including the authority to impose sanctions) in connection with a qualified board or exchange

- Any nongovernmental entity with self-regulatory powers (including the authority to impose sanctions) that was established by governmental regulations to perform an essential governmental function

Reporting Requirements.[271] For suits or agreements exceeding $600, the responsible government or entity official must file a return with the IRS stating the following.

- The total amount to be paid because of the suit or agreement

- Any amount to be paid for restitution or remediation of property

- Any amount to be paid for compliance

This return must be filed at the time the agreement is made. The responsible official must also simultaneously provide a statement to each person or entity that is a party to the suit or agreement that provides the:

1. Name of the government or entity, and

2. Information included in the return that the individual filed with the IRS.

For the purposes of the reporting requirements, a suit or agreement is defined as:

- A suit that results in a court order in which a government or entity has authority, or

- An agreement pertaining to a violation or potential violation of the law, over which a government or entity has authority.

Transitional Guidance.[272] According to the IRS's transitional guidance, reporting is not required until the date specified in the proposed regulations. This date is not to be earlier than January 1, 2019. Consequently, there are no reporting obligations for binding court orders or agreements existing before this date.

270. IRS Notice 2018-23, 2018-15 IRB 474.

271. IRC §6050X.

272. IRS Notice 2018-23, 2018-15 IRB 474.

S CORPORATION TO C CORPORATION CONVERSIONS

Old Law

Generally, when a corporation's status as an S corporation terminates, it reverts to a C corporation. Subsequent distributions made by a former S corporation during its post-termination transition period are treated as though an S corporation made the distributions.[273] The post-termination transition period is:[274]

1. The period beginning on the day after termination of S corporation status and ending on the **later** of:
   a. The day that is one year after the termination, or
   b. The due date for filing the return for the last year as an S corporation (including extensions);
2. The 120-day period beginning on the date of any determination pursuant to an audit following the termination of the corporation's S election and which adjusts a subchapter S item of income, loss, or deduction of the corporation arising during the S period; and
3. The 120-day period beginning on the date of a determination that the corporation's S election had terminated for a previous tax year.

When a corporation's S election is terminated, money distributed with respect to its stock **during** the post-termination transition period reduces the adjusted basis of the stock, to the extent that the amount of the distribution does not exceed the accumulated adjustments account.[275] Unless the corporation's shareholders elect otherwise, distributions from a terminated S corporation are treated as paid from its accumulated adjustment account if made during the post-termination transition period.[276]

Taxpayers who are required to change their accounting method (e.g., from cash to the accrual method), because of a conversion from an S corporation to a C corporation may be required to make IRC §481(a) adjustments to prevent income or expenses from being duplicated or omitted. Net adjustments that **decrease** taxable income are generally taken into account entirely in the year of change. However, net adjustments that **increase** taxable income are generally taken into account ratably over the 4-tax-year period starting with the year of change.[277]

New Law[278]

> **Note.** The 2018 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 4: C Corporations, contains more information about converting an S corporation to a C corporation.

Period Extended for Accounting Adjustments due to Corporate Conversions. An eligible terminated S corporation that revokes its S election during the **2-year period beginning on December 22, 2017**, has six years in which to ratably account for IRC §481(a) adjustments due to an accounting method change. This 6-year period begins with the year of the accounting method change.[279]

273. IRC §1371(e).
274. IRC §1377(b).
275. IRC §1371(e).
276. Ibid.
277. Rev. Proc. 2015-13, 2015-5 IRB 419.
278. TCJA §13543.
279. IRC §481(d).

For this purpose, an eligible terminated S corporation is any C corporation:

- Which was an S corporation on the day before December 22, 2017;
- Which during the 2-year period beginning on December 22, 2017, makes a revocation of its election under IRC §1362(a); and
- The corporate stock owners, determined on the date of revocation, are the same owners (and in identical proportions) as on December 22, 2017.[280]

Post-Termination Period Distributions. For distributions made by an eligible terminated S corporation after the post-termination period, the accumulated adjustments account is allocated to the distribution and the distribution is chargeable to the accumulated earnings and profits, in the same ratio that the accumulated adjustments account bears to the amount of accumulated earnings and profits.[281]

Revoking a Subchapter S Election. There is no specific form required to revoke an S election. The following steps should be taken.[282]

- File a statement titled "Revocation of S Corporation Status" with the IRS Service Center where the S election was filed. This letter should identify the name of the corporation, the tax identification number, the number of shares issued and outstanding, and the date the revocation is to be effective.
- The statement should be signed by any person authorized to sign the corporation's tax returns.
- Attach a statement of consent signed by shareholders owning more than 50% of the issued and outstanding shares of stock. The shareholder consent must be a written statement that states the shareholder's name, address, and taxpayer identification number, the number of shares owned by the shareholder, the date(s) on which the stock was acquired, the date on which the shareholder's tax year ends, the name of the S corporation, the corporation's taxpayer identification number, and that the shareholder consents to the revocation. The statement must be signed under penalties of perjury.

The following issues should be considered in determining whether to revoke an S election.

- When an S corporation converts to a C corporation, no immediate gain or loss is realized upon conversion.
- If a corporation has not distributed all its earnings to shareholders when it terminates its S election, it has only a limited period in which to do so before the distribution of such earnings will be taxed as a dividend.
- A revocation or termination can occur at any time during a tax year. If it occurs midyear, the corporation must file two tax returns for that year.
- Once the S election is revoked or terminated, the corporation cannot elect S status again for five years without IRS approval.[283]

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280. IRC §481(d)(2).

281. IRC §1371(f).

282. IRS Pub. 589, *Tax Information on S Corporations.*

283. Ibid.

EMPLOYEE ACHIEVEMENT AWARDS

Old Law

Generally, employers may deduct the cost of achievement awards given to employees for length of service or for safety achievement, up to the following amounts per employee.[284]

- $400 for all nonqualified employee achievement plan awards
- No more than $1,600 in aggregate for multiple qualified plan awards

All qualified and nonqualified employee achievement awards must meet the following requirements.

- Must consist of tangible personal property
- Must recognize an employee's length of service or safety achievement
- Must not be disguised compensation

Employers cannot deduct employee achievement awards consisting of cash, gift certificates, or equivalent items.[285]

New Law[286]

The TCJA specifically defines "tangible personal property" for the purposes of deductible employee achievement awards as **excluding** cash, cash equivalents, gift cards, gift coupons, and gift certificates. The term also **excludes** vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items.

> **Note.** This law change is intended to codify the existing tax treatment of employee achievement awards.[287]

LIMITATION ON EXCESSIVE EMPLOYEE COMPENSATION[288]

Old Law

Publicly held corporations cannot deduct more than $1 million in compensation to any covered employee for a tax year.[289] However, this $1 million limit is reduced by excess golden parachute payments that are not deductible by the corporation.[290]

Covered Employees. The following are considered covered employees of the corporation.[291]

- The principal executive officer (PEO)
- The principal financial officer (PFO)
- The three most highly compensated officers other than the PEO or PFO

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284. IRC §274(j).

285. IRC §274(j)(3)(ii).

286. TCJA §13310 and IRC §274(j)(3)(A)(ii).

287. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20 Statement.pdf] Accessed on May 15, 2018.

288. IRC §162(m).

289. IRC §162(m)(1).

290. IRC §162(m)(4)(F) prior to amendment by the TCJA §13543.

291. IRC §162(m)(3); IRS Notice 2007-49, 2007-25 IRB 1429.

Compensation Subject to the Limit.[292] Generally, taxable wages paid to the employee for services performed are subject to the deduction limit. However, the following compensation and benefits are not taken into account for this purpose.

- Specified commissions
- Performance-based compensation
- Income payable under a written binding contract that was in effect on February 17, 1993
- Compensation paid before a corporation became publicly held
- Payments to a tax-favored retirement plan (including salary reduction contributions)
- Amounts excludable from the executive's gross income (such as employer-provided health benefits and miscellaneous fringe benefits)

New Law[293]

The TCJA made two important changes effective for tax years beginning after December 31, 2017.

Covered Employee. The first change expanded the definition of a covered employee. This now includes employees who were covered employees of the corporation (or any predecessor) for any prior tax year beginning on or after January 1, 2017.[294]

Compensation Subject to Limit. The second change concerns compensation subject to the $1 million limit. Under the new law, commissions and performance-based compensation are taken into account for purposes of applying the limit.[295] However, a transition rule applies to compensation paid pursuant to a written binding contract in effect on November 2, 2017, which was not materially modified after that date. Such compensation continues to be excluded from amounts subject to the $1 million limit. This exception does not apply to new contracts entered into or existing contracts that are renewed after November 2, 2017.[296]

Publicly Held Corporation. The TCJA also changed the definition of publicly held corporation for the purposes of this provision. This is now defined as any corporation that is an issuer (as defined in §3 of the Securities Exchange Act of 1934 (SEA)):[297]

1. The securities of which are required to be registered under §12 of the SEA, or
2. That is required to file reports under §15(d) of the SEA.

QUALIFIED EQUITY GRANTS[298]

Old Law

Special rules apply to employees who receive property, including employer stock, for services performed. These rules affect the timing and the amount of the compensation that is recognized by the employee and deducted by the employer.

292. IRC §162(m)(4) and Treas. Reg. §1.162-27.

293. TCJA §13601.

294. IRC §162(m)(3).

295. IRC §§162(m)(4)(B) and (C); *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018.

296. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018.

297. IRC §162(m)(2) as amended by the TCJA §13601.

298. IRC §83.

Generally, the employee includes in income, in the first tax year when the property is substantially vested and freely transferable, the excess of the fair market value (FMV) of the property over any amount paid for the property.[299]

In the case of employer stock transferred to an employee, the employer is generally allowed a deduction corresponding to the amount included in the employee's income resulting from the transfer.[300]

IRC §83(b) Election. A taxpayer receiving property (including employer stock) for performance of services can elect to have the excess of the FMV of the restricted property over the amount paid taxed in the year the property is received. This election is possible even if the property is not substantially vested. When a proper and timely election is made, the FMV is determined as of the property transfer date. Once made, this restricted property election cannot be revoked without the IRS's consent.

The IRC §83 rules apply to grants of "restricted stock" (nonvested stock) but generally do not apply to the grant of options on employer stock unless the option has a readily ascertainable FMV.[301]

New Law[302]

Effective for stock attributable to options exercised, or restricted stock units settled, after December 31, 2017, a qualified employee of a privately held company (eligible corporation) may elect to defer income attributable to qualified stock transferred to the employee by the employer.

This election is both an alternative to being taxed in the year in which the property vests or in the year it is received.[303] When a qualified employee elects to defer this income, the employee must include the income in the tax year that includes the **earliest** of:

- The first date the qualified stock becomes transferable (including becoming transferable to the employer);
- The date the employee first becomes an excluded employee;
- The first date on which any stock of the employer becomes readily tradable on an established securities market;
- The date five years after the earlier of the first date the employee's right to the stock is transferable, or is not subject to a substantial risk of forfeiture; or
- The date on which the employee revokes this election.

The election to defer income for qualified stock must be made no later than 30 days after the first date the employee's right to the stock is substantially vested or is transferable, whichever occurs earlier.[304]

Eligible Corporation.[305] A corporation is an eligible corporation with respect to any calendar 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 United States (or any U.S. possession) are granted stock options, or restricted stock units (RSU), with the same rights and privileges to receive qualified stock.

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299. IRC §83(a).

300. IRC §83(h).

301. IRC §83(e)(3); Treas. Reg. §1.83-7.

302. TCJA §13603and IRC §83(i).

303. IRC §§83(a) and (b).

304. IRC §83(i)(4).

305. IRC §83(i)(2)(C).

Qualified Employees.[306] A qualified employee is an individual who agrees, in the inclusion deferral election, to meet the requirements the IRS deems necessary to ensure that the employer corporation's income tax withholding requirements regarding the qualified stock are met.

Excluded employees of the employer corporation cannot make the deferral election. This is anyone who:

1. Is a 1% owner of the corporation at any time during the calendar year, or was a 1% owner at any time during the 10 preceding calendar years;
2. 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;
3. Is a family member of an individual described in (1) or (2); or
4. Has been one of the four highest compensated officers of the corporation for the tax year or for any of the 10 preceding tax years.

Qualified Stock. Qualified stock is any stock in the employing corporation of the qualified employee if:[307]

- The stock is received in connection with the exercise of an option or in settlement of an RSU, and
- The option or RSU was granted by the corporation in connection with the performance of services as an employee and during a calendar year in which the corporation was an eligible corporation.

Qualified stock does not include any stock if the employee may sell the stock to, or otherwise receive cash in lieu of stock from, the corporation at the time that the rights of the employee in the stock first become transferable or not subject to a substantial risk of forfeiture.[308]

LENGTH-OF-SERVICE AWARD EXCLUSION[309]

Old Law

Bona fide safety volunteers working for a state or local government or a tax-exempt organization are not **currently** taxed on compensation deferred under an eligible deferred compensation plan that meets participation, deferral, payout, and other requirements.

A bona fide volunteer is an individual who receives no compensation for performing the qualified services other than:[310]

1. Reimbursements or reasonable allowances for expenses incurred in performing the services, or
2. Benefits and nominal fees for performing the services that are reasonable and customarily paid by tax-exempt and governmental employers for such services.

A length-of-service award plan does not qualify as an eligible deferred compensation plan for this treatment if the total amount of awards accrued for any year of service of any volunteer exceed $3,000.[311]

New Law[312]

Effective for years beginning after December 31, 2017, the annual accrued benefit limit for bona fide public safety volunteers increases from $3,000 to $6,000.

306. IRC §83(i)(3).
307. IRC §83(i)(2)(A).
308. IRC §83(i)(2)(B).
309. IRC §457(e)(11) and Treas. Reg. §1.457-2.
310. IRC §457(e)(11)(B).
311. IRC §457(e)(11)(B)(ii) prior to amendment by the TCJA §13612.
312. TCJA §13612 and IRC §457(e)(11)(B)(ii) as amended by the TCJA §13612.

LIMITATION ON DEDUCTION OF BUSINESS INTEREST[313]

Old Law

Depending on the taxpayer's method of accounting, interest expense incurred by a trade or business is generally deductible from business income in the year paid or accrued.

Trades or businesses that issue debt with original issue discount (OID) deduct the OID as interest over the life of the obligation on a yield to maturity basis.

There are limitations on the deduction of interest pertaining to the following debt instruments.

- Tax-exempt obligations
- Debt obligations not in registered form
- Insurance contracts
- OID on high-yield obligations

Interest allocable to the production of certain property may have to be capitalized.

Investment Income Limitation. Investment interest is interest paid or accrued by a noncorporate taxpayer on debt allocable to property held for investment that is otherwise deductible. The amount of investment interest deductible in a given tax year is limited to **net investment income.**[314] Any resulting excess investment interest expense is then carried forward indefinitely and offset against future investment income.

Investment income is the gross income from property held for investment or from its disposition. This includes interest received, annuities, dividends, royalties, and short-term gain on the disposition of property. The taxpayer may also elect to include as investment income some or all qualified dividends received and the excess of net long-term capital gains over net short-term capital losses for the year.[315]

Net investment income is the excess of investment income over allowable investment expenses (directly connected to the production of investment income).

Disqualified Interest of Corporations.[316] Generally, interest is disqualified if paid or accrued by a corporate taxpayer:

1. To a related person not subject to U.S. income tax on the interest,
2. On debt held by an unrelated person in which there is a disqualified guarantee by a related person, and
3. To a taxable REIT by a subsidiary of the trust.

A corporation **cannot** deduct disqualified interest paid or accrued during the tax year if the corporation has:

1. A debt-to-equity ratio exceeding 1.5 to 1.0 as of the close of the tax year, and
2. Net interest expense for the tax year that exceeds 50% of its adjusted taxable income.

Disallowed interest may be carried forward and treated as disqualified interest in succeeding tax years. Additionally, any excess limitation (i.e., the excess of 50% of the adjusted taxable income over net interest expense) can be carried forward three years.

This limitation is commonly referred to as the "earnings stripping" rule.

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313. IRC §163 and TCJA §13301.

314. IRC §163(d).

315. IRC §163(d)(4)(B).

316. IRC §163(j) prior to amendment by the TCJA §13301.

New Law[317]

Business Interest Defined. For these purposes, business interest expense is any interest paid or accrued on debt properly allocable to a trade or business of the taxpayer.[318] Business interest expense does not include investment interest. Similarly, business interest income is the amount of the taxpayer's includable interest income properly allocable to a trade or business and does not include investment income.[319]

The new law does not change the definition of investment interest and investment income for noncorporate taxpayers (contained in the "Old Law" section).

Exception for Small Businesses. An exception to the business interest limitation is provided for a small business that triggers the $25 million gross receipts test for use of the cash method of accounting after 2017.[320]

The $25 million gross receipts test is triggered for a tax year if average annual gross receipts of the business for the 3-tax-year period that ends with the tax year preceding such tax year exceeds $25 million.[321] The $25 million threshold is adjusted for inflation for tax years beginning after December 31, 2018.[322] For taxpayers that are not a corporation or partnership, the gross receipts test is applied in the same manner as if they were a corporation or partnership.[323] The small business exception is not available to tax shelters.[324]

Limitation on Business Interest. Effective for tax years beginning after December 31, 2017, the deduction for business interest is limited in any given tax year to the sum of the taxpayer's:

- Business interest income;
- 30% of adjusted taxable income for the year, including increases in adjusted taxable income from partnership or S corporation distributive shares (cannot be less than zero); and
- Floor plan financing interest.

This limitation on the deduction of business interest applies regardless of how the taxpayer's business is organized (i.e., corporation, partnership, sole proprietorship, etc.).

Generally, interest exceeding the deductible amount can be carried forward indefinitely to succeeding tax years, though certain restrictions apply for partnerships and S corporations.

For purposes of this limitation, the **adjusted taxable income** of a taxpayer is the taxpayer's regular taxable income computed without regard to the following.[325]

- Any item of income, gain, deduction, or loss not properly allocable to a trade or business
- Any business interest or business interest income
- Any NOL deduction
- The 20% deduction for qualified business income of a pass-through entity under IRC §199A
- Deductions for depreciation, amortization, or depletion in tax years beginning before January 1, 2022

317. IRC §163(j) and TCJA §13301.

318. IRC §163(j)(5) as amended by the TCJA §13301.

319. IRC §163(j)(6) as amended by the TCJA §13301.

320. IRC §§448(c)(1) as amended by the TCJA §13102 and 163(j)(3) as amended by the TCJA §13301.

321. IRC §448(c)(1) as amended by the TCJA §13102.

322. IRC §448(c)(4) as amended by the TCJA §13102.

323. IRC §163(j)(3) as amended by the TCJA §13301.

324. IRC §448(a) as amended by the TCJA §13102.

325. IRC §163(j)(8) as amended by the TCJA §13301.

This limitation applies after the application of other limitations on interest, including:[326]

- Deferred interest paid on an OID high-yield obligation, and
- The capitalization rules.

Carryforward Rules. Business interest that is not allowed as a deduction for the tax year due to the business interest deduction limitation may be carried forward and treated as business interest paid or accrued in the succeeding tax year.[327] The interest may be carried forward indefinitely, subject to certain restrictions for partnerships and S corporations as discussed next.

Application to Partnerships and S Corporations. The business interest deduction limitation is applied at the entity level for partnerships and S corporations when determining the nonseparately stated taxable income or loss of the entity.[328]

Each partner's or shareholder's adjusted taxable income is determined without regard to their distributive share of any item of income, gain, deduction, or loss of the partnership or S corporation.[329] This "double-counting" rule stops the same taxable income from being used to determine the business interest deduction limitation at both the entity and partner/shareholder level.

If a partnership or S corporation has excess taxable income for purposes of the deduction limit, then the excess is passed through to the partners or shareholders according to their distributive share.[330]

The **excess taxable income** of a partnership or S corporation is based on a **percentage** of the entity's adjusted taxable income (ATI) for the year, determined as follows.[331]

$$((\text{ATI} \times 30\%) - \text{excess business interest})) \div (\text{ATI} \times 30\%) \times \text{ATI} = \text{excess taxable income}$$

For this purpose, **excess business interest** is the amount by which the entity's business interest expense reduced by floor plan financing interest exceeds business interest income.

This addition to a partner's or shareholder's adjusted taxable income permits them to deduct more interest than they may have paid or incurred during the year, but only to the extent that the entity could have deducted more business interest.

Carryforward Rules for Partnerships and S Corporations. Unlike for other taxpayers, disallowed interest of a partnership or S corporation is not carried forward to the entity's succeeding tax year. Instead, this disallowed interest is treated as excess business interest allocated to each partner or shareholder in the same manner as any nonseparately stated taxable income or loss.[332]

Partners and shareholders treat the allocated excess business interest for the current tax year as pertaining to the next succeeding year, but this interest is then only deductible to the extent of excess taxable income from the entity allocated to the partner or shareholder in the succeeding year.[333]

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326. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018.
327. IRC §163(j)(2) as amended by the TCJA §13301.
328. IRC §§163(j)(4)(A)(i) and (D) as amended by the TCJA §13301.
329. IRC §§163(j)(4)(A)(ii)(I) and (D) as amended by the TCJA §13301.
330. IRC §§163(j)(4)(A)(ii)(II) and (D) as amended by the TCJA §13301.
331. IRC §§163(j)(4)(C) and (D) as amended by the TCJA §13301.
332. IRC §§163(j)(4)(B)(i) and (D) as amended by the TCJA §13301.
333. IRC §§163(j)(4)(B)(ii)(I) and (D) as amended by the TCJA §13301.

When a partner or shareholder has insufficient excess taxable income from the entity to offset the carried forward excess business interest, then this interest carries forward to succeeding tax years.[334] Again, this interest is only deductible to the extent of excess taxable income from the entity allocated to the partner or shareholder in the succeeding year.[335]

Partners and shareholders must reduce their basis in the entity (but not below zero) by the amount of excess business interest allocated by the entity to the partner or shareholder.[336] When the partner or shareholder disposes of their interest in the entity, their adjusted basis is increased immediately before the disposition by the excess (if any) of:[337]

1. The amount of the basis reduction due to the excess business interest allocated by the entity to the partner or shareholder, over
2. Any portion of the excess business interest allocated to the partner or shareholder that has previously been treated as interest paid or accrued by the partner.

A disposition for this purpose includes any transactions in which gain is not recognized in whole or part (including the death of the partner of shareholder). Lastly, the transferor or transferee are not allowed a deduction for any excess business interest that increases the adjusted basis in the entity.[338]

Floor Plan Financing. Property used in a trade or business that has floor plan financing indebtedness is not qualified property eligible for bonus depreciation if the interest paid on the floor plan is considered for purposes of the business interest deduction limitation.[339]

For this purpose, floor plan financing interest is interest paid or accrued on debt used to finance the acquisition of motor vehicles held for sale or lease and secured by the inventory.[340] A motor vehicle includes any self-propelled vehicle designed for transporting people or property on a public street, highway, or road, as well as a boat and farm machinery or equipment.

Trade or Business Activities. The performance of services as an employee is not considered a trade or business for purposes of calculating the business interest deduction limitation.[341] Consequently, wages are excluded from adjusted taxable income.

Taxpayers can also elect to exclude from the business interest deduction limitation any real property trade or business as defined under the passive activity rules. This includes the following real property trades or businesses.[342]

- Real estate development
- Redevelopment
- Construction
- Reconstruction
- Acquisition

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334. IRC §§163(j)(4)(B)(ii)(II) and (D) as amended by the TCJA §13301.

335. Ibid.

336. IRC §§163(j)(4)(B)(iii)(I) and (D) as amended by the TCJA §13301.

337. IRC §§163(j)(4)(B)(iii)(II) and (D) as amended by the TCJA §13301.

338. Ibid.

339. IRC §163(j)(9) as amended by the TCJA §13301.

340. Ibid.

341. IRC §163(j)(7)(A)(i) as amended by the TCJA §13301.

342. IRC §§163(j)(7)(A)(ii) and (B) as amended by the TCJA §13301; IRC §469(c)(7)(C).

- Conversion
- Rental
- Operation
- Management
- Leasing
- Brokerage trade or business

When the election is made for a real property trade or business, interest paid or accrued by that business is not considered business interest subject to the business interest deduction limitation. Once made, the election is irrevocable.

When an election is made to exclude a real property trade or business from the business interest limitation, that business must use ADS for certain property including nonresidential real property, residential rental property, and qualified improvement property.[343]

Taxpayers can also elect to exclude certain farming businesses from the business interest deduction limitation. These include farming businesses defined under the uniform capitalization rules and specified agricultural or horticultural cooperatives engaged in the following activities.[344]

- Land cultivation
- The raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees
- Operating a nursery or sod farm

When an election is made to exclude a farming business from the business interest limitation, that business must use ADS for any property with a recovery period of 10 years or more and that is not eligible for bonus depreciation.[345]

When the election is made for a farming business, interest paid or accrued by that business is not considered business interest subject to the business interest deduction limitation. Once made, the election is irrevocable.

> **Note**. The 2018 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 7: Agricultural Issues and Rural Investments, contains more information about interest deductions for farming businesses.

There is also an exception to the business interest deduction limitation for public utilities.[346]

EXEMPT ORGANIZATIONS

Excise Tax on Executive Compensation[347]

Old Law. Publicly held corporations cannot deduct more than $1 million in compensation paid to any covered employee for a tax year.[348] Generally, this limitation does not apply to tax-exempt organizations.

343. IRC §§163(j)(10)(A) as amended by the TCJA §13301 and 168(g)(8) as amended by the TCJA §13204.
344. IRC §§163(j)(7)(A)(iii) and (C) as amended by the TCJA §13301.
345. IRC §§163(j)(10)(B) as amended by the TCJA §13301 and 168(g)(1)(G).
346. IRC §163(j)(7)(A)(iv) as amended by the TCJA §13301.
347. TCJA §13602 and IRC §4960.
348. IRC §162(m)(1).

New Law. Effective for tax years beginning after December 31, 2017, exempt organizations must pay an excise tax on the remuneration of highly compensated employees. For a given tax year, a 21% excise tax (equal to the maximum corporate tax rate) is assessed on the sum of:

- Remuneration paid to a covered employee exceeding $1 million (not including any excess parachute payment) by an applicable tax-exempt organization, and
- Any excess parachute payments paid to a covered employee by that tax-exempt organization.

The terms "remuneration," "covered employee," "applicable tax-exempt organization," and "excess parachute payment" are defined in IRC §4960, as added by the TCJA.

Excise Tax on Investment Income of Private Foundations[349]

Old Law. Generally, private foundations (that are not exempt operating foundations) are subject to a 2% excise tax on their net investment income (NII).[350]

NII is defined as gross investment income and net capital gain, less expenses paid or incurred in earning this income. Tax-exempt interest on governmental obligations and related expenses are excluded from this calculation.[351] Gross investment income includes interest, dividends, rents, and royalties received by a private foundation from all sources, unless the income is taxable as unrelated business income under IRC §511.

When the qualifying charitable distributions made by a private foundation exceed the average historic level of its charitable distributions, the 2% excise tax is reduced to 1% of the foundation's NII. A private foundation meets this requirement if:

1. The amount of the qualifying distributions made during a tax year equals or exceeds the sum of:
   a. An amount equal to the assets of such foundation for the tax year multiplied by the average percentage payout for the five years immediately preceding the current tax year, plus
   b. 1% of the NII of such foundation for the tax year, and
2. Such private foundation was not liable for tax under IRC §4942 with respect to any year in the base period.

Generally, private colleges and universities are considered public charities (IRC §501(c)(3) educational organizations). In such cases, they are not subject to the private foundation excise tax on NII.

New Law. Effective for tax years beginning after December 31, 2017, private colleges and universities are treated like other private foundations and pay an excise tax of 1.4% of their NII as defined under existing law. This tax applies to educational institutions that meet all the following conditions.[352]

- Have at least 500 tuition-paying students during the preceding tax year, of which more than 50% are in the United States
- Are private educational institutions and not state colleges and universities (defined in IRC §511(a)(2)(B))
- Have at least $500,000 of assets per student (excluding assets used directly in carrying out the institution's exempt purpose) as measured at the end of the preceding tax year

For this purpose, student numbers are based on the daily average number of full-time students attending the institution, with part-time students being considered on a full-time student equivalent basis.

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349. TCJA §13701; IRC §4968; *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018.

350. IRC §4940(a).

351. IRC §4940(c)(5).

352. IRC §4968(b)(1).

Unrelated Business Taxable Income

Old Law. Unrelated business taxable income (UBTI) of an exempt organization is subject to the tax on UBTI imposed by IRC §511. This tax applies to income from a trade or business that is regularly operated by the organization. Additionally, the trade or business must not be substantially related to the organization's exercise or performance of the purposes or functions on which its exemption is based.[353]

When an organization has multiple unrelated businesses, the UBTI is aggregate gross income less aggregate allowed deductions from these businesses.[354] Thus, a deduction from one unrelated trade or business can offset income from another, thereby reducing UBTI.

The NOL deduction is allowed in determining UBTI, but only to the extent of UBTI.[355] NOLs can be carried back two years and forward 20 years.[356] Years in which there is no unrelated business income do not count toward expiration of the carryforward period.[357]

New Law.[358] For tax years beginning after December 31, 2017, UBTI is calculated separately for each unrelated business and without regard to the $1,000 specific deduction under IRC §512(b)(12).[359] The organization's UBTI is calculated by aggregating the positive UBTI from each of its unrelated businesses less the $1,000 specific deduction.[360] Trades or businesses with negative UBTI are excluded from this calculation.

The effects of this new rule are to:[361]

- Prevent income and deductions from different unrelated trades or business from offsetting each other in the same year,[362] and
- Allow only one specific $1,000 deduction regardless of how many unrelated businesses the exempt organization has.

These new rules do not prevent the carryover of unused deductions to subsequent tax years if they are utilized by the same unrelated business generating the carryover.[363]

Transition Rule. NOLs arising in tax years beginning before January 1, 2018, carried over to tax years beginning on or after January 1, 2018, are not subject to the rule requiring UBTI to be computed separately for each trade or business for purposes of determining the amount of the NOL. The NOL reduces the UBTI of the organization, which is the sum of the UBTI from each of its trades or businesses, less the specific deduction of $1,000.[364]

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353. IRC §513.
354. Treas. Reg. §1.512(a)-1.
355. IRC §512(b)(6).
356. IRC §172(b)(1)(A) prior to amendment by the TCJA §13302.
357. Treas. Reg. §1.512(b)-1(e).
358. TCJA §13702 and IRC §512(a).
359. IRC §512(a)(6)(C).
360. IRC §512(a)(6)(B).
361. IRC §512(a)(6).
362. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018.
363. Ibid.
364. TCJA §13702.

UBTI Increased by Certain Fringe Benefit Expenses

Old Law. Generally, fringe benefits are considered taxable compensation. However, the Code explicitly excludes from an employee's income the following fringe benefits.[365]

- A no-additional-cost service
- Qualified employee discounts
- Working condition fringe benefits
- De minimis fringe benefits
- Qualified transportation fringe benefits
- Qualified moving expense reimbursements
- Qualified retirement planning services
- Qualified military base realignment and closure fringe benefit payments
- Certain employer-provided eating and athletic facilities
- Use of certain demonstrator automobiles

New Law.[366] Effective for amounts paid or incurred after December 31, 2017, disallowed employee fringe benefits are treated as **additions** to an exempt organization's UBTI.[367] Disallowed fringe benefits are nondeductible expenses, and specifically include:[368]

- Qualified transportation fringe benefits,[369]
- Qualified parking facilities,[370] and
- On-premises athletic facilities.[371]

However, this provision only applies to the organization's disallowed fringe benefits that are **not** associated with any unrelated business of the organization.[372]

365. IRC §132.
366. TCJA §13703.
367. IRC §512(a)(7).
368. IRC §274.
369. IRC §132(f).
370. IRC §132(f)(5)(C).
371. IRC §132(j)(4)(B).
372. IRC §512(a)(7).

SIGNIFICANT INTERNATIONAL PROVISIONS

Foreign Company Participation Dividends Received Deduction[373]

Old Law. Generally, U.S. taxpayers are subject to U.S. tax on their worldwide income.[374] Therefore, a U.S. taxpayer is subject to U.S. tax on foreign compensation attributable to a foreign business. However, a U.S. taxpayer who is a shareholder in a foreign corporation generally is not subject to U.S. tax on the foreign corporation's earnings until they are distributed to the U.S. taxpayer as dividends.[375]

> **Note.** Historically, U.S. companies have preferred to accumulate rather than distribute foreign company earnings to avoid subjecting distributions of those earnings to high U.S. corporate tax rates.

There are nevertheless several exceptions to this general rule, which are often referred to as anti-deferral rules. Examples of these anti-deferral rules include the following.

- Shareholders who own 10% or more of the shares of controlled foreign corporations (CFC) are currently taxed on their pro-rata shares of the CFC's subpart F income without regard to whether the income is distributed to the shareholders.[376]
- Passive foreign investment company (PFIC) rules apply to shareholders of foreign corporations producing significant amounts of passive income.[377]

Foreign Tax Credit. To prevent double taxation, foreign tax credits can be claimed against U.S. taxes owed on foreign-source income.[378] This double-tax relief applies regardless of whether the income is earned directly by the U.S. taxpayer, repatriated as an actual dividend, or included in the taxpayer's income pursuant to anti-deferral rules.[379] Foreign tax credits can be claimed for most income, war profits, and excess profits taxes paid or accrued during the tax year to a foreign country or U.S. possession.[380]

New Law.[381] Effective for distributions made after December 31, 2017, domestic corporations are taxed according to a more territorial-based tax system rather than the worldwide tax system used historically. The participation exemption DRD is central to this new corporate tax system. Henceforth, a domestic corporation can claim a 100% deduction for the foreign-source portion of a dividend received from a specified 10%-owned foreign corporation in which the domestic corporation is a U.S. shareholder.[382]

> **Note.** Because of the law change, the United States moves to a territorial system of taxing U.S. corporations on the foreign earnings of their foreign subsidiaries. Consequently, these foreign earnings are effectively only subject to host country tax, because U.S. shareholder companies receive a 100% participation DRD.

373. IRC subpart F (§§951–965).

374. IRC §61.

375. *Concepts of Foreign Personal Holding Company Income*. Feb. 29, 2016. IRS [www.irs.gov/pub/int_practice_units/DPLCU_P_2_3_13.pdf] Accessed on Jul. 30, 2018.

376. IRC §951(a).

377. *Passive Foreign Investment Companies*. Blikshteyn, Vadim. Oct. 1, 2011. The Tax Adviser [www.thetaxadviser.com/issues/2011/oct/clinic-story-04.html] Accessed on Jul. 30, 2018.

378. IRC §904.

379. IRC §§901 and 960; *Sec. 962 to the Rescue*. Polantz, Raymond M. Aug. 1, 2015. [www.thetaxadviser.com/issues/2015/aug/sec-962-to-the-rescue.html] Accessed on Jul. 30, 2018.

380. Treas. Reg. §1.901-2.

381. TCJA §14101 and IRC §245A.

382. IRC §245A(a).

For this purpose, a specified 10%-owned foreign corporation is any foreign corporation in which a domestic corporation is a U.S. shareholder (other than a PFIC that is not a CFC). In addition, a U.S. shareholder is one that owns (directly or constructively) 10% or more of the voting stock of the foreign corporation.

Exceptions.[383] The 100% participation DRD does not apply in the following situations in which tax treatment continues under existing law.

- Dividends from foreign companies that are less than 10% owned by domestic corporations[384]
- Dividends from foreign companies received by noncorporate U.S. shareholders[385]
- U.S. shareholders that are not regulated investment companies or REITs[386]
- Dividends from PFICs that are not CFCs[387]
- Hybrid dividends received by a U.S. shareholder from a CFC[388]
- Foreign company dividends on stocks held by U.S. shareholders for less than the minimum time specified by the TCJA[389]
- Dividends from IRC §501 tax-exempt organizations and IRC §521 tax-exempt farmers' cooperative associations[390]

Foreign Tax Credit/Deduction. No credit or deduction can be claimed for any foreign income taxes paid or accrued with respect to the participation DRD.[391]

Mandatory Repatriation Tax on Overseas Earnings of Foreign Subsidiaries

Old Law.[392] As mentioned in the preceding section, a U.S. taxpayer who is a shareholder in a foreign corporation generally is not subject to U.S. tax on the foreign corporation's earnings until they are distributed to the U.S. taxpayer as dividends. Because of this tax treatment, many U.S. corporate shareholders accumulate rather than repatriate foreign earnings due to the high U.S. corporate tax rate that they would be subject to.

383. IRC §245A and *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20 Explanatory%20Statement.pdf] Accessed on May 15, 2018.

384. IRC §§245A(b) and 951(b).

385. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20 Statement.pdf] Accessed on May 15, 2018.

386. Ibid.

387. Ibid.

388. IRC §245A(e)(1).

389. IRC §246(c)(5)(A).

390. IRC §246(a)(1).

391. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20 Statement.pdf] Accessed on May 15, 2018.

392. IRC §965 prior to amendment by the TCJA §14103; *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/ billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018.

To encourage U.S. companies to repatriate their accumulated foreign earnings and invest them in the United States, the American Jobs Creation Act of 2004 added IRC §965.[393] This provided a temporary 85% dividends-received deduction (DRD) for certain cash dividends received by U.S. corporate shareholders from CFCs for one tax year (at the taxpayer's election, either the taxpayer's first tax year beginning on or after October 22, 2004, or during the taxpayer's last tax year beginning before such date). However, the following limitations applied.

- Only cash repatriations exceeding the taxpayer's average repatriation level calculated for a 3-year base period preceding the year of the deduction were generally considered.
- Dividends eligible for the deduction were generally limited to foreign earnings.
- Dividends must have been invested in the United States according to a domestic reinvestment plan approved by the taxpayer's senior management and board of directors.

Foreign Tax Credit/Deduction. No credit or deduction could be claimed for any foreign income taxes attributable to the deductible portion of any dividends.

Note. The effect of this provision was to subject 15% of foreign company dividends to U.S. corporate tax before consideration of any credit or deduction for foreign taxes attributable to this taxable income.

New Law.[394] For the last tax year of a foreign corporation beginning before January 1, 2018, U.S. shareholders are subject to a mandatory repatriation tax on overseas income of specified foreign corporate subsidiaries.

A specified foreign corporation is any foreign corporation in which a U.S. person owns a voting interest of at least 10%. PFICs that are not also CFCs are excluded.

The overseas income subject to this tax is the U.S. shareholder's pro rata share of the accumulated post-1986 deferred foreign income of the corporation that was not previously subject to U.S. tax.[395] This deemed foreign income repatriation is taxed at the following rates.

- 15.5% when the foreign earnings are attributable to the U.S. shareholder's cash position
- 8% when foreign earnings are attributable to non-cash assets

A U.S. shareholder with a deemed foreign income repatriation under §965 can offset this repatriation tax with an allocable foreign tax credit.

Note. This "one-time" tax payment is tied to the move to a territorial system of taxation under which a 100% participation DRD is available for foreign company dividend distributions made after December 31, 2017 (see the preceding section). Requiring affected U.S. corporate shareholders of foreign companies to pay this one-time tax stops these U.S. corporations from obtaining a potential tax windfall on deferred post-1986 foreign company earnings.

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393. PL 108-357.

394. TCJA §14103. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on May 15, 2018; IRC §965 as amended by the TCJA.

395. IRC §965, as amended by TCJA §14103.

An exception applies to a corporation that becomes an expatriated entity (as defined by IRC §7874(a)(2)) within the 10-year period following enactment. The deemed foreign income repatriation of affected U.S. shareholders of such corporations is subject to a 35% tax rate (with no foreign tax credit permitted).[396]

Special rules are provided for S corporations and REITs.[397]

Elections. Various taxpayer elections are available regarding the §965 tax, as described in the following table.

Note. More information regarding these elections is provided at **uofi.tax/18b1x2** [www.irs.gov/newsroom/questions-and-answers-about-reporting-related-to-section-965-on-2017-tax-returns].

Election	Governing Provision
Election to pay net tax liability under §965 in installments over an 8-year period	IRC §965(h)(1)
S corporation shareholder election to defer payment of net §965 tax liability	IRC §965(i)(1)
Statement for REITs electing deferred inclusions under §951(a)(1) by reason of §965	IRC §965(m)(1)(B)
Election not to apply NOL deduction	IRC §965(n)
Election to use alternative method to compute post-1986 earnings and profits	IRS Notice 2018-13, §3.02

Note. For questions and answers regarding the tax reporting and payment requirements pertaining to the one-time §965 tax, see **uofi.tax/18b1x3** [www.irs.gov/newsroom/questions-and-answers-about-reporting-related-to-section-965-on-2017-tax-returns].

396. IRC §965(l) as amended by TCJA §14103.

397. IRC §§965(i) and (m) as amended by TCJA §14103.

OTHER PROVISIONS

Other business, international, and miscellaneous provisions contained in the TCJA are summarized in the following tables.

Other Business Provisions

TCJA Section	IRC Section	Description	Effective date(s)
13522	101	Exception to transfer for valuable consideration rules	Transfers after December 31, 2017
13312	118	Certain contributions by governmental entities not treated as contributions to capital	Generally, after December 22, 2017
13821	139G, 247, and 6039H	Modification of tax treatment of Alaska native corporations and settlement trusts	Tax years beginning after December 31, 2016
13532	149(d), 148(f)(4)(C)	Repeal of advance refunding bonds	Bonds issued after December 31, 2017
13307	162	Denial of deduction for settlements subject to nondisclosure agreements paid in connection with sexual harassment or sexual abuse	After December 22, 2017
13308	162(e)	Repeal of deduction for local lobbying expenses	Amounts paid or incurred on or after December 22, 2017
13311	162	Elimination of deduction for living expenses incurred by members of Congress	Tax years beginning after December 22, 2017
13531	162	Limitation on deduction for FDIC premiums	Tax years beginning after December 31, 2017
13801	263A(f)	Production period for beer, wine, and distilled spirits	Calendar years beginning after December 31, 2017
13613	402(c)	Extended rollover period for plan loan offset amounts	Tax years beginning after December 31, 2017
13221	451	Certain special rules for taxable year of inclusion	Tax years beginning after December 31, 2017
13503	704	Charitable contributions and foreign taxes taken into account in determining limitation on allowance of partner's share of loss	Tax years beginning after December 31, 2017
13502	743(d)	Modify definition of substantial built-in loss in the case of transfer of partnership interest	Transfers of partnership interests after December 31, 2017
13511	805(b), 810, 844, 831(b)(3), 381, 805, 953, 1351(i)(3)	NOLs of life insurance companies	Tax years beginning after December 31, 2017

Other Business Provisions *(continued)*

TCJA Section	IRC Section	Description	Effective date(s)
13512	806, 453B(e), 465, 801, 804, 805, 842, 953	Repeal of small life insurance company deduction	Tax years beginning after December 31, 2017
13517	807, 808, 7702, 811(d), 846(f)(6), 848(e)(1)(B)(iii), 954(i)(5)	Computation of life insurance tax reserves	Tax years beginning after December 31, 2017
13513	807(f)	Adjustment for change in computing reserves	Tax years beginning after December 31, 2017
13518	812	Modification of rules for life insurance proration for purposes of determining the dividends received deduction	Tax years beginning after December 31, 2017
13514	815, 801	Repeal of special rule for distributions to shareholders from pre-1984 policyholders surplus account	Tax years beginning after December 31, 2017
13515	832(b)(5)(B)	Modification of proration rules for property and casualty insurance companies	Tax years beginning after December 31, 2017
13523	846	Modification of discounting rules for property and casualty insurance companies	Tax years beginning after December 31, 2017
13516	847	Repeal of special estimated tax payments	Tax years beginning after December 31, 2017
13519	848	Capitalization of certain policy acquisition expenses	Tax years beginning after December 31, 2017
13501	864(c), 1446	Treatment of gain or loss of foreign persons from sale or exchange of interests in partnerships engaged in trade or business within the United States	Dispositions on or after November 27, 2017 or December 31, 2017
13521	1016(a)	Clarification of tax basis of life insurance contracts	Transactions entered into after August 25, 2009
13313	1044	Repeal of rollover of publicly traded securities gain into specialized small business investment companies	Sales after December 31, 2017
13309	1061	Recharacterization of certain gains in the case of partnership profits interests held in connection with performance of investment services	Tax years beginning after December 31, 2017
13314	1221(a)(3), 1231(b)(1)(C)	Certain self-created property not treated as a capital asset	Dispositions after December 31, 2017

Other Business Provisions *(continued)*

TCJA Section	IRC Section	Description	Effective date(s)
13822	4261(e)	Amounts paid for aircraft management services	After December 22, 2017
13604	4985(a)(1)	Increase in excise tax rate for stock compensation of insiders in expatriated corporations	After December 22, 2017
13807	5001	Reduced rate of excise tax on certain distilled spirits	Spirits removed after December 31, 2017
13806	5041	Definition of mead and low alcohol by volume wine	Wine removed after December 31, 2017
13805	5041(b)	Adjustment of alcohol content level for application of excise taxes	Wine removed after December 31, 2017
13804	5041(c)	Reduced rate of excise tax on certain wine	Wine removed after December 31, 2017
13802	5051(a)	Reduced rate of excise tax on beer	Beer removed after December 31, 2017
13808	5212	Bulk distilled spirits	Distilled spirits transferred in bond after December 31, 2017
13803	5414, 5412	Transfer of beer between bonded facilities	Calendar quarters beginning after December 31, 2017
13520	6050Y, 6724, 6047	Tax reporting for life settlement transactions	Policy sales and death benefits after December 31, 2017
13404	6431, 1397E, 54(1)(3)(B), 6211(b)(4)(A), 6401(b)(1)	Repeal of tax credit bonds	Bonds issued after December 31, 2017

Miscellaneous Provisions

TCJA Section	IRC Section	Description	Effective date(s)
14502	864(e)	Repeal of FMV method of interest expense apportionment	Tax years beginning after December 31, 2017
14501	1297(b)(2)(B)	Restriction on insurance business exception to passive foreign investment company rules	Tax years beginning after December 31, 2017

Other International Provisions

TCJA Section	IRC Section	Description	Effective date(s)
14223	1(h)(11)(C)(iii)	Shareholders of surrogate foreign corporations not eligible for reduced rate on dividends	Dividends received after December 22, 2017
14401	59A	Base erosion and anti-abuse tax	Tax years beginning after December 31, 2017
14202	250, 172(d), 246(b)(1), 469(i)(3)(F)(iii)	Deduction for foreign-derived intangible income and global intangible low-taxed income	Tax years beginning after December 31, 2017
14222	267A	Certain related-party amounts paid or accrued in hybrid transactions or with hybrid entities	Tax years beginning after December 31, 2017
14303	863(b)	Source of income from sales of inventory determined solely on basis of production activities	Tax years beginning after December 31, 2017
14301	902, 960, 78	Repeal of §902 indirect foreign tax credits; determination of §960 credit on current year basis	Generally, tax years beginning after December 31, 2017
14302	904(d)	Separate foreign tax credit limitation basket for foreign branch income	Tax years beginning after December 31, 2017
14304	904(g)	Election to increase percentage of domestic taxable income offset by overall domestic loss treated as foreign source	Tax years beginning after December 31, 2017
14221	936(h)(3)(B), 367(d)(2), 482	Limitations on income shifting through intangible property transfers	Tax years beginning after December 31, 2017
14215	951(a)(1)	Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply	Generally, tax years beginning after December 31, 2017
14214	951(b)	Modification of definition of U.S. shareholder	Generally, tax years beginning after December 31, 2017
14201	951A, 960, 904	Current year inclusion of global intangible low taxed income by U.S. shareholders	Generally, tax years beginning after December 31, 2017
14211	954, 952	Elimination of inclusion of foreign base company oil related income	Generally, tax years beginning after December 31, 2017
14212	955, 951, 851, 952, 953, 964, 970	Repeal of inclusion based on withdrawal of previously excluded subpart F income from qualified investment	Generally, tax years beginning after December 31, 2017
14213	958(b)	Modification of stock attribution rules for determining status as a controlled foreign corporation	Generally, the last tax year beginning before January 1, 2018, and subsequent years
14102	1248, 961, 964(e), 91, 367(a)	Special rules relating to sales or transfers involving specified 10% owned foreign corporations	Generally, tax years beginning after December 31, 2017

BIPARTISAN BUDGET ACT OF 2018[398]

On February 9, 2018, President Trump signed into law the Bipartisan Budget Act of 2018 (BBA). In addition to funding the government through March 23, 2018, the legislation contained a package of tax extenders, which provided a 1-year extension for many key provisions that had expired on December 31, 2016. Additionally, the legislation contained other tax-related provisions, including changes relating to tax relief for the California wildfire disaster area.

> **Note.** The provisions affecting businesses are described in this section. The provisions affecting individuals are described in the 2018 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 1: New Legislation — Individual Concerns.

EXTENDERS

The following extender provisions affect businesses.

BBA Section	IRC Section	Description	Expiration date(s)
40312	30A, 936	Extension of American Samoa economic development credit	December 31, 2017
40301	45A(f)	Extension of Indian employment tax credit	December 31, 2017
40302	45G(f)	Extension of railroad track maintenance credit	December 31, 2017
40303	45N(e)	Extension of mine rescue team training credit	December 31, 2017
40304	168(e)(3)(A)(i)	Extension of classification of certain race horses as 3-year property	December 31, 2017
40305	168(i)(15)(D)	Extension of 7-year recovery period for motor-sports entertainment complexes	December 31, 2017
40306	168(j)(9)	Extension of accelerated depreciation for business property on an Indian reservation	December 31, 2017
40307	179E(g)	Extension of election to expense mine safety equipment	December 31, 2017
40308	181(g)	Extension of special expensing rules for certain productions	December 31, 2017
40309	199(d)(8)(C)	Extension of deduction allowable with respect to income attributable to domestic production activities in Puerto Rico	December 31, 2017
40310	1201(b)	Extension of special rule relating to qualified timber gain	December 31, 2017
40311	1391(d)(1)(A)(i)	Extension of empowerment zone tax incentives	December 31, 2017

398. PL 115-123; Summary of the Tax Extenders Agreement. Senate Finance Committee.

The following extender provisions affect energy production and conservation.

BBA Section	IRC Section	Description	Expiration date(s)
40401	25C(g)(2)	Extension of credit for nonbusiness energy property	December 31, 2017
40402	25D	Extension and modification of credit for residential energy property	December 31, 2021
40403	30B(k)(1)	Extension of credit for new qualified fuel cell motor vehicles	December 31, 2017
40404	30C(g)	Extension of credit for alternative fuel vehicle refueling property	December 31, 2017
40405	30D(g)(3)(E)(ii)	Extension of credit for 2-wheeled plug-in electric vehicles	December 31, 2017
40406	40(b)(6)(J)(i)	Extension of second generation biofuel producer credit	December 31, 2017
40407	40A, 6426(c)(6), 6427(e)(6)(B)	Extension of biodiesel and renewable diesel incentives	December 31, 2017
40408	45(e)(10)(A)	Extension of production credit for Indian coal facilities	December 31, 2017
40409	45(d)	Extension of credits with respect to facilities producing energy from certain renewable resources	December 31, 2017
40410	45L(g)	Extension of credit for energy-efficient new homes	December 31, 2017
40411	48(a) and 48(c)	Extension and phaseout of energy credit	December 31, 2021
40412	168(l)(2)(D)	Extension of special allowance for second generation biofuel plant property	December 31, 2017
40413	179D(h)	Extension of energy efficient commercial buildings deduction	December 31, 2017
40414	451(k)(3)	Extension of special rule for sales or dispositions to implement FERC or state electric restructuring policy for qualified electric utilities	December 31, 2017
40415	6426(d)(5), (e)(3), and 6427(e)(6)(C)	Extension of excise tax credits relating to alternative fuels	December 31, 2017
40416	4611(f)(2)	Extension of oil spill liability trust fund financing rate	December 31, 2018

TAX RELIEF FOR CALIFORNIA WILDFIRE DISASTER AREA

The BBA provides tax benefits for taxpayers in the California wildfire disaster area. The term **California wildfire disaster area** is defined as the area in which a major disaster was declared by the president because of wildfires in California between January 1, 2017, and January 18, 2018.[399]

> **Note.** The provision that affects businesses in the California wildfire disaster area is described in this section. In addition, there are several provisions that affect individual taxpayers in the California wildfire disaster area. These are described in the 2018 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 1: New Legislation — Individual Concerns.

Employee Retention Credit[400]

Old Law. An employer can claim the work opportunity credit for wages paid to certain individuals. The amount of the work opportunity credit is generally 40% of the qualified first-year wages paid by the employer to individuals who are members of a targeted group.[401]

> **Note.** For further information about the targeted groups for purposes of the work opportunity credit, see **uofi.tax/18b1x4** [www.irs.gov/businesses/small-businesses-self-employed/work-opportunity-tax-credit].

New Law. Eligible employers may claim a California wildfire employee retention credit equal to 40% of qualified wages paid to each eligible employee during the tax year. An **eligible employer** is one that conducted a trade or business on October 8, 2017, in the California wildfire disaster area and that trade or business was inoperable on any day after October 8, 2017, and before January 1, 2018, because of damage sustained from the wildfires. An **eligible employee** is one who was employed on October 8, 2017, in the California wildfire disaster area by an eligible employer. **Qualified wages** is defined as wages paid or incurred by an eligible employer to an eligible employee on any day after October 8, 2017, and before January 1, 2018, that occurs during the period:

- Beginning on the date the trade or business first became inoperable, and
- Ending on the date on which the trade or business resumes significant operations.

The maximum amount of qualified wages that may be taken into account for any individual is $6,000.

399. PL 115-123, §20101.

400. PL 115-123, §20103.

401. IRC §§51 and 38(b).

OTHER PROVISIONS

The BBA contains several other tax-related provisions. The provisions affecting businesses and nonprofit organizations are summarized in the following table.

BBA Section	IRC Section	Description	Expiration date(s)
40501	45J	Modification of credit for production from advanced nuclear power facilities	Tax years beginning after February 9, 2018
41119	45Q	Enhancement of carbon dioxide sequestration credit §101(a)(3)(A)	Tax years beginning after December 31, 2017
20201	51 and 52	Tax relief for hurricanes Harvey, Irma, and Maria	After September 29, 2017
41115	1400Z-1(b)	Opportunity zone rule for Puerto Rico	December 22, 2017
41110	4943	Exception from private foundation excess business holding tax for independently operated philanthropic business holdings	Tax years beginning after December 31, 2017
41109	4968(b)(1)	Clarification regarding excise tax based on investment income of private colleges and universities	Tax years beginning after December 31, 2017
41112	5555(a)	Simplification of rules for brewers regarding records, statements, and returns	Calendar quarters beginning after February 9, 2018
41117	6050W(d)(1)(B)	Treatment of foreign persons for returns relating to payments made in settlement of payment card and third-party network transactions	Calendar years beginning after December 31, 2017
41102	7652(f)(1) and 7652(e)	Modification of rum cover over	Distilled spirits brought into the United States after June 30, 1999, and before January 1, 2022
41111	N/A	Rule of construction for craft beverage modernization and tax reform	December 22, 2017
41118	6655	Repeal of shift in time of payment of corporate estimated taxes (for corporations with assets of at least $1 billion)	February 9, 2018

CONSOLIDATED APPROPRIATIONS ACT[402]

On March 23, 2018, President Trump signed into law the Consolidated Appropriations Act, 2018 (CAA).[403] The CAA is a $1.3 trillion omnibus spending bill, which details how the government can spend money. It contains funding for the IRS and several tax provisions, including technical corrections to tax legislation, amendments to the partnership audit regime, and modifications to the deduction for qualified business income of agricultural cooperatives. The most noteworthy provisions include the following.

- Qualified business income — The deduction for qualified business income of a cooperative and its patrons is modified.[404]

> **Note.** The deduction for qualified business income of agricultural cooperatives is covered in the 2018 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 7: Agricultural Issues and Rural Investments.

- Low-income housing credit — The CAA increased the credit ceiling and added an average income test.[405]
- Earned income credit — The $5,000 increase in the phaseout amount for MFJ couples was made permanent.
- Section 529 and ABLE programs — The CAA repealed the rules providing that 529 accounts must be aggregated for purposes of calculating the distribution amount included in a taxpayer's income.
- Centralized partnership audit rules — The CAA added a number of clarifications and several procedural modifications to the centralized partnership audit rules applicable to tax years beginning after December 31, 2017. It also created an alternative procedure the IRS is to implement permitting individual partners to elect to report their shares of the partnership-level imputed underpayment and pay their shares of any tax deficiency without having to file amended returns.

> **Note.** For a complete list and explanation of the technical corrections, see the Joint Committee on Taxation report JCX-6-18, which can be downloaded at **uofi.tax/18b1x5** [www.jct.gov/publications.html?func=startdown&id=5064]. This report also contains a detailed explanation of the centralized partnership audit rules.

402. Joint Committee on Taxation, *Technical Explanation of the Revenue Provisions of the House Amendment to the Senate Amendment to H.R. 1625 (Rules Committee Print 115-66)* (JCX-6-18), Mar. 22, 2018.

403. PL 115-141.

404. IRC §199A.

405. IRC §42.