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2017 Tax Act Frequently Asked Questions (FAQs)

From the Editors

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CORPORATE & BUSINESS

Corporate Tax Rate

1. **How will a corporation with a fiscal year that begins in 2017 and ends in 2018 determine its tax rate? Will it be a blended or prorated rate**?

Section 13001(c)(1) of the 2017 tax act provides that a corporate income tax rate reduction to a flat 21% rate is effective for tax years beginning after December 31, 2017. Section 15 (which was not changed by the act) provides that if the tax rate changes for tax years beginning after or ending after a certain date, the following day (i.e., January 1, 2018, in this case) is considered the effective date of the change. Because nothing in the 2017 tax act appears to contradict or override §15 with respect to corporations, it appears that a prorated rate must be used by fiscal corporations. By contrast, §1(j)(6), *as added by* §11001 of the 2017 tax act, specifies that §15 does not apply to the rate changes for individuals, estates, and trusts. [I.R.C. §1, §11, §15; Act §11001, §13001; 507 T.M., V.]

2. **What is the capital gains rate for corporations?**

For tax years beginning before January 1, 2018, capital gains realized by corporations were subject to the regular corporate income tax rates, with a maximum rate of 35%. For tax years beginning after December 31, 2017, the maximum rate on capital gains has been repealed as obsolete and capital gains realized by corporations are subject to the flat 21% corporate income tax rate. [§11; Act §13001; 701 T.M., I.B.1.c.]

3. **Does the 21% corporate tax rate apply to personal service corporations?**

Effective for tax years beginning after December 31, 2017, all corporations are subject to a flat 21% income tax rate. Accordingly, if a personal service corporation (also referred to as a professional service corporation) is classified as a

C corporation (i.e., has not elected to be an S corporation), it should be subject to the 21% rate. Former §11(b)(2), which imposed a 35% rate on personal service corporations, was repealed by §13001(a) of the 2017 tax act. [I.R.C. §11, §1361(a)(2); Act §13001; 700 T.M., II.J.2.]

Depreciation and Expensing

1. Was qualified improvement property assigned a class life in the 2017 tax act? If not, will the class life revert to 39 years for depreciation purposes?

The 2017 tax act removed qualified improvement property (QIP) from the list of specific types of property eligible for bonus depreciation. However, it appears that no substantive change was intended. Rather, it was simply intended as a conforming amendment reflecting the relocation of the definition of QIP from §168(k)(3) to §168(e)(6) . Because Congress apparently intended to classify QIP as 15-year property, QIP would still meet the definition of qualified property in §168(k)(2)(A) after the act (which requires that property have a recovery period of 20 years or less), were it not for the unintentional drafting omission. However, Congress did not add QIP to the list of 15-year property in § 168(e)(3)(E), and Congress's addition of a cross-reference to nonexistent §168(e)(3)(D)(V) in the table in § 168(g)(3)(B) suggests an intent to add QIP, which would classify it as a 10-year property. In the absence of a technical correction, building improvements generally must be depreciated over the 39-year life of the building and, thus, are not eligible for bonus depreciation. It is unclear whether the IRS will challenge a taxpayer's deduction of bonus depreciation or a shorter recovery period for QIP acquired and placed in service after September 27, 2017. [I.R.C. §168(e), §168(k); Act §13201, §13204; 532 T.M., III.A.]

Business Interest Limitation

1. Is the election to opt out of the new rules surrounding the deductibility of business interest a permanent, irrevocable election that binds for the current and all future years? Or is it an annual election? —

Section §163(j)(7) allows real property trades or businesses and farming businesses to elect out of being treated as a trade or business for purposes of the business interest limitation (although if they do so, they will be subject to different depreciation rules). Section §163(j)(7)(B) and §163(j)(7)(C) provide that the election (which must be made in a time and manner to be provided by the IRS) is irrevocable. Thus, once the election is made, it applies for all future years. Because the taxpayer is unable to revoke the election, it seems clear that the taxpayer would not be making the election annually – there would be nothing to "elect." [I.R.C. §163(j); Act §13301; 536 T.M., X.F.]

Meals, Entertainment, and Transportation Costs

1. How did the 2017 tax act affect a taxpayer's ability to deduct entertainment and meal expenses?

The 2017 tax act amended §274, effective for amounts paid or incurred after December 31, 2017 to provide that a taxpayer is not allowed a deduction for (1) an activity generally considered to be entertainment, amusement, or recreation; (2) membership dues for a club organized for business, pleasure, recreation, or other social purposes; or (3) a facility (or portion of a facility) used in connection with any of the above, regardless of whether the expenses are directly related to (or associated with) the active conduct of the taxpayer's trade or business. With respect to meal expenses (food and beverages), a taxpayer is still allowed to deduct 50% of these expenses if they are associated with the operation of their trade or business. For example, a taxpayer may deduct 50% of the expenses for meals that employees consume while on work travel. For amounts incurred and paid after December 31, 2017, but before

January 1, 2026, a taxpayer may also deduct 50% of expenses associated with providing food and or beverages to employees through an eating facility on, or near, the employer's business premises that meets the requirements of a de minimis fringe benefit and is provided for the employer's convenience. However, this deduction will not be applicable to amounts paid or incurred after December 31, 2025. [I.R.C. §274; Act §13301; 520 T.M., I.C.]

2. Can employers deduct transportation costs included in an employee's income?

The 2017 tax act amended §274 to deny deductions for any expense (including reimbursement) for transportation of an employee between the employee's residence and place of employment. The deduction continues to apply, however, to expenses necessary for ensuring the safety of the employee. Pre-existing law excepts expenses treated as wages for income tax withholding purposes from the general disallowance rules. [I.R.C. §274(l); Act §13304; 519 T.M., III.B.]

Net Operating Losses

1. If a taxpayer has an NOL carryforward from a prior year that was getting close to the end of the 20-year carryover period, can that NOL now be carried forward indefinitely? Or does the indefinite carryforward apply only to newly generated NOLs? —

The 2017 tax act made a number of changes to the treatment of NOLs. In most cases, it eliminated carrybacks of NOLs but also eliminated the 20-year limitation on carrying forward unused NOLs. It also limited the amount of an NOL that could be deducted in any one year. However, the "effective date" provision of the changes to the carryback and carryforward rules is significant—the changes apply only to NOLs arising in tax years ending after December 31, 2017. Accordingly, the 20-year carryforward limit continues to apply to NOLs that arose tax years ending before January 1, 2018. And because NOLs must be used in the earliest year to which they may be carried, old NOLs subject to the pre-2018 carryforward restriction would be used before new NOLs not subject to that restriction. [I.R.C. §172; Act §13302; 539 T.M., IV.]

Alternative Minimum Tax

1. Does the repeal of the alternative minimum tax (AMT) for C corporations eliminate the need to track pre-2018 general business credits separately (where pre-2018 credits could not offset AMT)?

The repeal of the corporate AMT will affect the treatment of general business credits and their carryover. Before the 2017 tax act, a taxpayer could claim the general business credit only to the extent of the excess of the taxpayer's net income tax over the greater of (1) tentative minimum tax or (2) 25% of so much of the taxpayer's net regular tax liability as exceeds $25,000. This limitation was amended by the 2017 tax act to provide that a corporation's tentative minimum tax is treated as zero for this purpose, effective for tax years beginning after December 31, 2017. No retroactive change is required, but the amendment does affect credit carryovers going forward. However, the overall limitation (which is now equal to the excess of the taxpayer's net income tax over 25% of the taxpayer's net regular tax liability that exceeds $25,000) still applies. As a result, taxpayers may still be limited in the amount of businesses credits that can be used and should keep track of them for purposes of carryovers. [I.R.C. §38; Act §12001; 506 T.M., VI.B.1.b.(3)]

Mergers & Acquisitions

1. What impact will the 2017 tax act have on tax-related aspects of merger and acquisition negotiations?

The 2017 tax act includes a number of provisions that will be important to consider when pricing M&A transactions, undertaking due diligence, and seeking appropriate certifications and other contractual protections. Here are the primary issues:

- New limitations on the use of net operating losses.
- Transition tax on deemed income inclusions.
- 100% expensing for the cost of certain assets.
- New withholding tax on sales of partnerships engaged in U.S. trades or businesses.
- New limitations on business interest expense deductions.
- Repeal of partnership technical termination provision.

For further discussion of this topic, see Sarah-Jane Morin, Gregory Hartker, and Daniel A. Nelson., "M&A and Tax Reform—New Tax Considerations with Wide-Ranging Implications," 15 Daily Tax Report J-1 (Jan. 23, 2018).

Pass-Through Entities

1. Now that C corporations are taxed at a flat rate of 21%, under what circumstances would it make sense for an existing pass-through entity to convert to a C corporation or a new business venture to be organized as a C corporation?

The answer to this question is highly dependent upon the particular facts and circumstances. There is no "one size fits all" answer. There are several factors relevant to the new tax act that must be carefully evaluated, including but not limited to the following:

- Taking into consideration the type of business and the extent to which any of the limitations would apply, to what extent would the new 20% deduction on combined qualified business income lower the effective tax rate if the business is organized as a pass-through?
- To what extent can the owners avoid or eliminate the second level of tax that is applicable if the entity is organized as a C corporation? What are the owners' current and future plans with respect to cash distributions from the entity? Will earnings be distributed on a regular basis or will they be re-invested in the growth of the business?
- If the entity intends to retain cash, will there be an accumulated earnings tax or personal holding company tax issue? An accumulated earnings tax of 20% applies to companies holding cash at certain thresholds. A personal holding company tax of 20% applies to undistributed passive income earned in a closely held C corporation.
- Is the company expecting losses? Although a pass-through entity's losses can, under certain circumstances, flow through to owners and offset other types of income, the new limitation on excess business losses must be considered.
- Can the owners take advantage of the use of §1202 small business stock to eliminate some or all of the gain on the eventual sale of the C corporation stock?
- How do the changes to the international tax rules affect the taxation of the entity?

For more information, see "Tax Law Prompts S Corps to Examine Their Structures: A Primer," 17 Daily Tax Report G-2 (Jan. 25, 2018).

2. What is the deadline for an S corporation to revoke its S election in order for the revocation to apply for the entire tax year?

A company must revoke a subchapter S election by the 15th day of the third month of the tax year (March 15 for a calendar year taxpayer) in order for the revocation to apply to the entire tax year. If a company elects to terminate its S corporation status, it cannot reapply for S corporation status for five years. [I.R.C. §1362; Act §14543; 730 T.M., III.F.2., IV.B.2.]

Deduction for Qualified Business Income of Pass-Through Entities

1. What is the deduction for qualified business income from pass-through entities?

[**Editor's Note:** The 2018 CAA (Pub. L. No. 115-141, Div. T. §101) amended §199A to remove the deduction for qualified cooperative dividends. The deduction is equal to the combined qualified business income amount subject to a taxable income limitation.]

Section §199A was added to the Code by the 2017 tax act. It permits a taxpayer other than a corporation (including trusts and estates) to deduct a certain amount of qualified business income (QBI) from pass-through entities (sole proprietorships, partnerships and S corporations). The deduction is equal to 20% of the6151132659680891 taxpayer's combined qualified business amount income plus 20% of qualified cooperative dividends, subject to various limitations. There are essentially two categories that make up the "combined qualified business income amount." The first category is equal to the sum of the deductible amounts for each of the taxpayer's qualified trades or businesses (which is equal to 20% of the "qualified business income" from each of the taxpayer's qualified trades or businesses (subject to certain limitations)). The second category is equal to 20% of the aggregate amount of qualified REIT dividends and qualified publicly traded partnership income. The deduction is not a deduction for the pass-through entity itself. The deduction is available for tax years beginning after December 31, 2017, but before January 1, 2026. [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.]

2. How is the overall amount of the deduction for qualified business income from pass-through entities calculated?

[**Editor's Note:** The 2018 CAA (Pub. L. No. 115-141, Div. T. §101) amended §199A and the deduction is equal to the lesser of: (a) the taxpayer's combined qualified business income amount, or (b) an amount equal to 20 of the excess (if any) of the taxpayer's taxable income over any net capital gain. The 2018 CAA eliminated the deduction for qualified cooperative dividends.]

The deduction is equal to the sum of:

- The lesser of:
  a. the taxpayer's combined qualified business income amount, or
  b. an amount equal to 20% of the excess (if any) of the taxpayer's taxable income over any net capital gain and qualified cooperative dividends, plus
- The lesser of:
  c. 20% of qualified cooperative dividends, or
  d. taxable income (reduced by net capital gain).

This combined amount cannot exceed the taxpayer's taxable income (reduced by net capital gain). [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.]

3. What is the combined qualified business income amount?

There are two categories that make up "combined qualified business income." The first category is equal to the sum of the deductible amounts for each of the taxpayer's qualified trades or businesses (which is equal to 20% of the "qualified business income" from each of the taxpayer's qualified trades or businesses (subject to certain limitations). The second category is equal to 20% of the aggregate amount of qualified REIT dividends and qualified publicly traded partnership income. Thus, combined qualified business income is equal to:

- The sum of the deductible amounts determined for each qualified trade or business carried on by the taxpayer; plus
- 20% of the aggregate amount of qualified REIT dividends and qualified publicly traded partnership income of the taxpayer. [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.]

4. How does a taxpayer determine the deductible amount for each qualified trade or business?

First, the taxpayer determines whether a particular trade or business is a "qualified trade or business." Second, the taxpayer computes "qualified business income" for each qualified trade or business for the tax year. Third, the taxpayer applies the W-2 wages and qualified property limitation (if applicable). [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.]

5. What is a "qualified trade or business" for purposes of §199A?

A qualified trade or business is any trade or business other than (1) a specified service trade or business" or (2) the trade or business of performing services as an employee. [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.]

6. What businesses are "specified service trades or businesses" ineligible for the deduction for qualified business income?

A specified service trade or business is any trade or business involving the performance of services in the fields of:

- health;
- law;
- accounting;
- actuarial science;
- performing arts;
- consulting;
- athletics;
- financial services;
- brokerage services; and
- any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners.

However, the performance of services in the fields of architecture and engineering have been specifically excluded from this list.

A specified service trade or business also includes a trade or business that involves the performance of services that consist of:

- investing and investment management;
- trading or dealing in securities;
- trading or dealing in partnership interests; and
- trading or dealing in commodities.

[I.R.C. §199A; Act §11011; 701 T.M., I.B.2.]

7. Are there any circumstances in which a taxpayer is able to deduct qualified business income from a specified service trade or business?

If a taxpayer's taxable income does not exceed an applicable threshold amount (adjusted for inflation), the specified service trade or business exclusion does not apply and the taxpayer is allowed a deduction with respect to the QBI of that trade or business. For 2018 the threshold amount is $315,000 for joint filers and $157,500 for all other taxpayers. The specified service trade or business exclusion phases in for taxpayers with taxable income in excess of the applicable threshold amount and is fully phased in for taxpayers with taxable income in excess of the applicable threshold amount plus $100,000 for joint filers and $50,000 for other taxpayers. The exclusion is phased in based on the ratio of taxable income in excess of the threshold amount to $100,000 or $50,000, whichever is applicable. [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.]

8. Is a rental real estate activity considered a qualified trade or business for purposes of the §199A deduction?

There is no specific definition of a "trade or business" for purposes of §199A . Section §199A does not specifically refer to §162 but the phrase "trade or business" in §199A most likely refers to a §162 trade or business (regular, continuous and substantial). If this is the case, then a rental real estate activity that rises to the level of a §212 activity but not a §162 trade or business would not be a qualified trade or business for purposes of the deduction. There is currently no guidance on the circumstances under which a rental real activity rises to the level of a §162 trade or business for purposes of the §199A deduction. The §1411 (net investment income tax) regulations provide some guidance, but it is not technically applicable to §199A . Additional guidance from the IRS is needed. [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.a.]

9. How does a taxpayer compute "qualified business income" for each qualified trade or business? —

For each qualified trade or business, qualified business income is equal to the net amount of qualified items of income, gain, deduction, and loss with respect to the qualified trade or business. Items of income, gain, deduction, and loss are qualified items only to the extent that (1) they are included or allowed in the determination of the taxpayer's taxable income for the tax year, and (2) they are effectively connected with the conduct of a trade or business within the United States or Puerto Rico. [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.a.]

10. What is excluded from "qualified business income"?

[**Editor's Note:** The 2018 CAA (Pub. L. No. 115-141, Div. T., §101) amended §199A(c)(3)(B)(ii) to provide that an amount described in §1385(a)(1) (patronage dividends) shall not be excluded from qualified business income.]

QBI does not include:

- short-term or long-term capital gain or loss;
- dividends, income equivalent to a dividend, or payments in lieu of dividends;
- interest income (other than interest income properly allocable to a trade or business);
- gain or loss described in §954(c)(1)(C) (commodities transactions) or §954(c)(1)(D) (foreign currency gains);
- income, gain, deduction, or loss taken into account under §954(c)(1)(F) (income from notional principal contracts);
- amounts received from annuities that are not received in connection with the trade or business; and
- any item of deduction or loss properly allocable to an amount described above.

In addition, QBI also does not include:

- any amount paid by a qualified trade or business for services rendered that is treated as reasonable compensation of a taxpayer;
- any guaranteed payment by a partnership to a taxpayer for services rendered with respect to the trade or business; and
- to the extent provided in future regulations, any amount paid by a partnership to a taxpayer acting other than in his or her capacity as a partner for services.

[I.R.C. §199A; Act §11011; 701 T.M., I.B.2.]

11. Is §1231 capital gain excluded from the definition of qualified business income?

[**Editor's Note:** The 2018 CAA (Pub. L. No. 115-141, Div. T., §101) amended §199A(c)(3)(B) to strike the term "investment" from the description of items not taken into account. Thus, §1231 gain is excluded from qualified business income.]

The answer to this is not entirely clear. Section 199A(c)(3)(B)(i) provides that qualified business income does not include "any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss." That wording would seem to exclude §1231 gain from qualified business income. However, the introductory sentence to the list of items in §199A(c)(3)(B) refers to those items as "investment items" – that wording would imply that §1231 gain is not excluded because it is not technically an "investment item." Although it is likely that Congress intended to exclude §1231 gain from qualified business income, clarification would be helpful. [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.].

12. Does the §199A deduction apply to both passive and active income?

Yes. The deduction applies to "qualified business income" and there is no requirement that qualified business income be active income. Thus, a passive investor can claim the §199A deduction. [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.]

13. What happens if a taxpayer's net amount of qualified business income from all of the taxpayer's qualified trades or businesses is less than zero?

If a taxpayer's net amount of qualified business income with respect to all of its qualified trades or business is less than zero, that amount is carried forward and treated as a loss from a qualified trade or business in the succeeding tax year, which means that it reduces the available deduction in that year. [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.]

14. What is the W-2 wage and qualified property limitation on qualified business income?

The W-2 wage and qualified property limitation essentially limits a taxpayer's deductible amount with respect to a qualified trade or business to the lesser of (1) 20% of the taxpayer's qualified business income, or (2) the greater of (a) 50% of the W-2 wages with respect to the trade or business, or (b) the sum of (i) 25% of the W-2 wages with respect to the trade or business, plus (ii) 2.5% of the unadjusted basis (immediately after acquisition) of all qualified property. W-2 wages are defined as the total wages subject to wage withholding, elective deferrals, and deferred compensation paid by the qualified trade or business with respect to employment of its employees during the calendar year ending during the tax year of the taxpayer.

W-2 wages do not include (1) any amount that is not properly allocable to the QBI as a qualified item of deduction, and (2) any amount that was not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for filing such return. Qualified property is defined as tangible property of a character subject to depreciation (1) that is held by, and available for use in, the qualified trade or business at the end of the tax year, (2) that is used in the production of QBI, and (3) for which the depreciable period has not ended before the end of the tax year. The depreciable period with respect to qualified property is defined as the period beginning on the date the property is first placed in service by the taxpayer and ending on the later of (1) the date 10 years after that date, or (2) the last day of the last full year in the applicable recovery period that would apply to the property under §168 (without regard to §168(g)). [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.]

15. Are there taxpayers who are excluded from the W-2 wage and qualified property limitation on qualified business income?

If the taxpayer's taxable income is below an applicable threshold amount (adjusted for inflation), the W-2 wage limitation does not apply to limit the taxpayer's deduction for QBI. For 2018 the threshold amount is $315,000 for joint filers and $157,500 for all other taxpayers. The W-2 wage limitation phases in for a taxpayer with taxable income in excess of the applicable threshold amount and is fully phased in for a taxpayer with taxable income in excess of the applicable threshold amount plus $100,000 for joint filers and $50,000 for other taxpayers. The limitation is phased in based on the ratio of taxable income in excess of the threshold amount to $100,000 or $50,000, whichever is applicable. [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.]

16. How does the "W-2 wage" and qualified property limitation for the 20% deduction for pass-through entity income work in practice, and what sort of planning can be done to minimize its impact?

The special definition of "W-2 wages" for the limitation on the 20% deduction for pass-through entity income in § 199A partially mirrors language in the former §199 domestic production activities deduction, so some helpful guidance on this issue can be found in Rev. Proc. 2006-22 and in the §199 regulations. For §199A, the W-2 wage

limitation depends on a variety of factors, including the type of business the taxpayer operates, the taxpayer's taxable income, and the unadjusted basis of the business's depreciable assets.

For a discussion of this topic and ideas on how to begin planning, see Ruth M. Wimer, "Tax Reform: Form W-2 Significance for Pass-Through 20% Section 199A Deduction," 10 Daily Tax Report J-1 (Jan. 16, 2018). [I.R.C. former §199, §199A; Act §11011; 701 T.M., I.B.2.]

17. Does the W-2 wage and qualified property limitation apply to real estate investment trusts (REITs) or publicly traded partnerships (PTPs)?

No. Qualified REIT dividends are generally any dividends received from a REIT other than any portion of a dividend that is a capital gain dividend or a qualified dividend under §1(h)(11).Qualified publicly traded partnership income is generally, with respect to any qualified trade or business, the sum of (1) the net amount of the taxpayer's allocable share of qualified items, and (2) gain recognized by the taxpayer on the disposition of its interests in the PTP that is treated as ordinary income. A taxpayer is allowed to deduct 20% of qualified REIT dividends and 20% of qualified publicly traded partnership income, subject only to the overall taxable income limitations provided in §199A(a) . [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.]

18. Are trusts and estates able to claim the §199A deduction for qualified business income from pass-through entities?

Yes. Trusts and estates are eligible for the deduction. For purposes of the W-2 wage limitation, rules similar to the rules under former §199A apply for apportioning any W-2 wages and unadjusted basis of qualified property between fiduciaries and beneficiaries. [I.R.C. §199A; Act §11011; 701 T.M., I.B.2.]

19. How will the §199A deduction for qualified business income of pass-through entities apply to electing small business trusts?

It is not clear how the §199A deduction will apply to electing small business trusts (ESBTs). The legislative history broadly states that trust and estates are eligible for the deduction. But §641(c) may present some technical issues. There are limited adjustments that can be made to the S corporation portion of an ESBT. However, it is clear Congress intended the 20% deduction would be available to ''trusts,'' which include ESBTs. Guidance from the IRS would be useful. [I.R.C. §199A; Act §11011; H.R. Conf. Rep. No 115-466 224; 701 T.M., I.B.2.]

20. What are qualified cooperative dividends?

[**Editor's Note:** The 2018 CAA (Pub. L. No. 115-141, Div. T., §101) amended §199A(c)(3)(B) to eliminate the deduction for qualified cooperative dividends and modified the special rules for specified agricultural and horticultural cooperatives and their patrons. Originally, 199A(g) only provided a deduction for the cooperative itself. After amendment by the 2018 CAA, rules similar to former §199 apply for specified agricultural and horticultural cooperatives. A special rule prevents a double benefit for patrons and requires them to reduce their combined qualified business income amount by the lesser of (1) 9% of QBI properly allocable to qualified payments from a cooperative, or (2) 50% of the w-2 wages allocable to such qualified payments. A transition rule continues the application of former §199 for qualified payments received by patrons from specified agricultural or horticultural cooperatives in tax years beginning after 2017 if such payment is attributable to qualified production activities of the cooperative in tax years beginning before 2018.]

Qualified cooperative dividends are any patronage dividend (as defined in §1388(a)), any per-unit retain allocation (as defined in §1388(f)), and any qualified written notice of allocation (as defined in §1388(c)), or any similar amount received from an organization which is governed by the rules applicable to cooperatives before the enactment of subchapter T. [I.R.C. §199A; Act §11011]

21. How does the deduction for qualified business income compare to the deduction for qualified cooperative dividends?

[**Editor's Note:** The 2018 CAA (Pub. L. No. 115-141, Div. T., §101) amended §199A(c)(3)(B) to eliminate the deduction for qualified cooperative dividends and modified the special rules for specified agricultural and horticultural cooperatives and their patrons. Originally, 199A(g) only provided a deduction for the cooperative itself. After amendment by the 2018 CAA, rules similar to former §199 apply for specified agricultural and horticultural cooperatives. A special rule prevents a double benefit for patrons and requires them to reduce their combined qualified business income amount by the lesser of (1) 9% of QBI properly allocable to qualified payments from a cooperative, or (2) 50% of the w-2 wages allocable to such qualified payments. A transition rule continues the application of former §199 for qualified payments received by patrons from specified agricultural or horticultural cooperatives in tax years beginning after 2017 if such payment is attributable to qualified production activities of the cooperative in tax years beginning before 2018.]

Both qualified business income (QBI) and qualified cooperative dividends (QCD) are eligible for a 20% deduction. However, the QBI deduction is based on net income, while the QCD deduction is based on gross income. In addition, the QBI deduction is subject to the W-2 wage limitation and a lower taxable income limitation (20% of taxable income), while the QCD deduction is not subject to the W-2 wage limitation and is subject to a higher taxable income limitation (100% of taxable income). These rules create tax incentives for farmers to sell their products through cooperatives instead of independent dealers. For example, a farmer with grain worth $100,000 and related expenses of $80,000 would be allowed a QCD deduction of $20,000 ($100,000 x 20%) if the grain is sold through a cooperative, but a QBI deduction of only $4,000 (($100,000 - $80,000) x 20%) if the grain is sold through an independent dealer. Although this example assumes that none of the limitations apply, note that the QBI deduction is more likely to be subject to limitation than is the QCD deduction. [I.R.C. §199A; Act §11011]

22. Will the state and local tax (SALT) deduction limit also apply to property taxes/income taxes paid by a pass-through? If so, it is expected that these items will now be "separately stated items"?

The limitation applies to individuals but does not apply to property taxes paid or accrued in a trade or business or a § 212 expense. Accordingly, property taxes paid, for example, in a real estate partnership entered into for profit would not be subject to the limitation. This exception does not apply to income taxes. It is not clear what the result would be if, for an example, a corporation that was an S corporation for federal purposes but not for state purposes were to pay state income tax. It is also not clear whether SALT would be treated as separately stated items. [I.R.C. §164; Act § 11042; 525 T.M., II.A.]

Excess Business Loss

1. If a loss is disallowed under the excess business loss limitation, how is the carryforward affected by that limitation in future years?

It appears that the excess business loss limitation is a "one and done" provision in that it applies to a loss once, in the current tax year. To the extent a loss is disallowed under §461(l) in the current tax year, it is carried forward and, in subsequent years, its deductibility should no longer be affected by the application of §461(l) . The §172 limitations

will apply, but §461(l) should not. Although this is not explicitly stated in the statutory language, it appears to be the result based on the treatment of the carryforward as a §172 NOL. [I.R.C. §172, §461(l); Act §11012, §13302; 718 T.M., II.B.4.]

Note: This discussion was drawn from an article in the Tax Management Memorandum by Lisa M. Starczewski and Bruce Booken. For more, see "A Deep Dive Into New Limitations on Loss and Business Interest Reveals Complexity, Uncertainty, and Need for Correction," 59(4) Tax Mgmt. Memorandum 47 (Feb. 19, 2018).

INTERNATIONAL

Territorial System of Taxation

1. Should the new international tax system be considered a territorial system? —

Proponents of the 2017 tax act have described the changes as a move to a "territorial" tax system from a worldwide system. However, while the act does incorporate certain features typically associated with a territorial tax system, such as a 100% dividend exemption, the 100% dividend exemption is something that few are eligible to attain and those who meet its strict requirements must wait a long time before they experience its benefits. In other ways, such as through the new global intangible low-taxed income (GILTI) and base erosion and anti-abuse tax (BEAT) provisions, the act makes the U.S. tax rules more extraterritorial. [I.R.C. §245A; Act §14101(a); 926 T.M.]

For a detailed discussion of this topic and the international provisions of the 2017 tax act more generally, see John L. Harrington, "Territoriality and Extraterritoriality: The Impact of the 2017 Tax Act on Corporations, Individuals, and Pass-Through Entities," 47(2) Tax Mgmt. Int'l J. 79 (Feb. 9, 2018).

2. What is the one-time transition (or, mandatory repatriation) tax?

Multinational corporations with deferred foreign income are required to pay a one-time tax as part of the transition to a "participation exemption system" of taxation. The repatriation of such deferred income is deemed to take place in the corporation's last taxable year beginning before January 1, 2018. The amount of deferred foreign income deemed repatriated generally is taxed at the rate of 15.5% on earnings held in cash or cash equivalents, and 8% for illiquid assets. Treasury and IRS have prioritized providing guidance and clarity on this topic. See Notice 2018-07; Notice 2018-13; and Rev. Proc. 2018-17. [I.R.C. §965; Act §14103; 930 T.M., IX.]

3. What is the 100% dividends received deduction?

Under new §245A, U.S corporate shareholders of specified foreign corporation are generally entitled to deduct the foreign-source portion of dividends received from such foreign corporation. Specified foreign corporations include any foreign corporation which has a U.S. corporate shareholder, excluding passive foreign investment companies (PFICs) which are not controlled foreign corporations (CFCs). As it applies to dividends from a CFC, the §245A deduction will primarily apply to distributions of returns on tangible assets because much of a CFC's earnings will be subject to current U.S. tax without the distribution requirement. Neither a foreign tax credit nor a deduction is available for any foreign taxes paid with respect to a dividend for which a §245A deduction is allowed. The statute grants Treasury broad regulatory authority, and specifically identifies regulations for the treatment of U.S. shareholders owning stock of certain foreign corporations through a partnership. [I.R.C. §245A; Act §14101(a); 930 T.M., X.]

Global Intangible Low-Taxed Income

1. Should the new international tax system be considered a territorial system?

The act added new §951A, which requires each U.S. shareholder of any controlled foreign corporation (CFC) to include in gross income the U.S. shareholder's global intangible low-taxed income (GILTI) in generally the same manner as the shareholder would include subpart F income. The tax on GILTI is designed to impose a minimum residual tax on "above-routine" CFC earnings, with the "routine" CFC earnings generally defined as a 10% return on the CFC's tangible property. U.S. shareholders are required to aggregate their GILTI amounts from all CFCs with respect to which they are a U.S. shareholder. [I.R.C. §951A; Act §14201; 926 T.M., XVIII.]

Base Erosion and Anti-Abuse Tax

1. What is the base erosion and anti-abuse tax (BEAT)?

The base erosion and anti-abuse tax (BEAT) under new §59A is an alternative tax applicable to certain U.S. corporations and U.S. branches of foreign corporations, including foreign corporations with income that is effectively connected with a U.S. trade or business. The BEAT ensures that corporations cannot make use of "base erosion payments" (deductible payments paid or accrued to a related foreign entity) to lower their U.S. tax liability. The amount of the BEAT generally is equal to the excess of 10% of the taxpayer's modified taxable income over an amount determined on the basis of the taxpayer's regular tax liability. The BEAT only applies to large corporations, i.e., with at least $500 million in annual gross receipts over the previous three taxable years. The BEAT does not apply to individuals, S corporations, real estate investment trusts (REITs), or regulated investment companies (RICs). [I.R.C. §59A; Act §14401; 6580 T.M., II.C.3.]

Transfer Pricing

1. Does the 2017 tax act have any impact on transfer pricing, particularly as it relates to the transfer of intangible property?

The 2017 tax act modifies §482 for the first time in 30 years, adding language that requires the "valuation of intangible property . . . on an aggregate basis or the valuation of such transfer on the basis of the realistic alternatives." Much the same language was added to §367(d)(2), which governs the transfer of intangibles. These amendments apply to transfers in tax years starting after December 31, 2017. The aggregation and realistic alternative principles are not new concepts; they appear in §482 regulations dating to 1994 (and later clarified in 2015). However, they are new to the statute, raising questions as to the reasons for codifying those concepts and how the IRS might interpret the change. Apparently the new language is intended as a brake on inappropriate shifting of profits across borders, but it's worth noting that (a) it draws on language from Obama-era budget proposals and (b) the IRS has consistently lost cases in which it attempted to apply those principles in recharacterizing transactions involving the transfer of intangibles (see Veritas Software Corp. v. Commissioner, 133 T.C. 297 (2009)). [I.R.C. § 367(d)(2), §482; Act §14221; 886 T.M., I.]

For a deeper discussion of this topic, see David Ernick, "Transfer Pricing After Codification of Aggregation and Realistic Alternatives Principles," 47(2) Tax Mgmt. Int'l J. 132 (Feb. 9, 2018).

Withholding Taxes

1. How does the new withholding tax under §1446(f) compare to the withholding taxes in §1441 and §1442?

The 2017 tax act created two new withholding regimes under new §1446(f) : a "primary" withholding regime and a " secondary" withholding regime. These new withholding taxes relate to gain on a transfer of certain partnership interests that is taxable on a net basis (after deductions) as effectively connected with a trade or business in the U.S. (ECI), unlike the withholding taxes imposed by pre-existing §1441 and §1442, which are imposed on fixed or determinable annual or periodical (FDAP) income (which excludes gain on transfers of property) that is taxed on a gross basis. Consequently, the two new withholding tax regimes under §1446(f), which relate to income that is treated as ECI, do not necessarily bear any relationship to the primary taxpayer's actual U.S. tax liability (if any) under new §864(c)(8), and, unlike withholding under §1441 and §1442, cannot eliminate that taxpayer's requirement to file a U.S. tax return. See Reg. §1.6012-2(g)(2) . [I.R.C. §1441, §1442, §1446(f); Act §13501(b); 910 T.M., VI.]

Note: This discussion was drawn from an article in the Daily Tax Report by David F. Chan. For more, see "New Section 1446(f) Withholding—A Possible Outline for Public Guidance," 27 Daily Tax Rep. 11 (Feb. 8, 2018).

Foreign Tax Credits

1. How does the new withholding tax under §1446(f) compare to the withholding taxes in §1441 and §1442?

Section 960 generally provides that when undistributed earnings of a controlled foreign corporation (CFC) are taxed to a U.S. corporation under §951 or §951A, the U.S. corporation may be deemed to have paid a portion of the foreign income taxes attributable to such item of income. The 2017 tax act expanded the definition of a U.S. shareholder and a CFC, and removed the requirement that the taxpayer and the CFC be a member of the same "qualified group" under former §902(b). Both of these amendments expanded the eligibility of taxpayers able to claim the credit. The act also amended the calculation of the credit by replacing the multi-year "pooling" approach in favor of a current-year calculation. Under the current-year approach, a shareholder is deemed "to have paid so much of such foreign corporation's foreign income taxes as are properly attributable to such item of income." As part of the transition to a current-year basis, any amounts of deferred income existing in the pools previously used in the §960 calculation are subject to a one-time transition tax under §965. [I.R.C. §960; Act §14301; 902 T.M., III.D.]

2. How does the 2017 tax act affect the calculation of the §904 foreign tax credit limitation?

In determining the limit to the amount a taxpayer can claim as a foreign tax credit, §904 requires the taxpayer to categorize its foreign-source gross income into separate groups of income set forth in §904(d). From 2004 to 2018, the categories were generally limited to passive category income and general category income. However, the act added two new categories of income, one for foreign branch income and another for amounts includible in gross income as global intangible low-taxed income (GILTI) under §951A. Foreign branch income is defined as the business profits of a U.S. person which are attributable to one or more qualified business units (QBUs) in one or more foreign countries. Both new categories specifically exclude passive category income. Thus, any amounts that will be characterized under the new limitation baskets are amounts that would have otherwise been general category income. [I.R.C. §904, §951A; Act §14201, §14302; 6060 T.M., VI.]

Transition Tax

Reponses under this heading were prepared by Clark Armitage and Kirsten Burmester of Caplin & Drysdale on Feb. 23, 2018, as a follow-up to a webinar they conducted with Bloomberg Tax.

1. What is the effective date of the repeal of §958(b)(4)? Does the tax affect 2017 individual calendar year filers?

Answer: Section 958(b)(4) is repealed for the last tax year of a foreign corporation beginning before January 1, 2018. So it will affect the December 31, 2017, tax year of a foreign corporation on a calendar tax year, and it will affect the tax year of a United States shareholder within which or with which that year ends.

In the case of an individual United States shareholder with a calendar tax year, that shareholder will have reporting requirements and potentially §965, GILTI, and Subpart F inclusions for his or her 2017 tax year with respect to a foreign corporation impacted by the rule if the foreign corporation has a December 31, 2017, tax year. [IRC §958(b); Act §14213; 926 T.M., VI.]

2. Will the one-time transition tax be calculated on the December 2017 tax return or the December 2018 tax return?

It depends on the tax year of the United States shareholder and the foreign corporation. The post-1986 deferred foreign income of the foreign corporation is treated as an addition to Subpart F income for the last tax year of a specified foreign corporation beginning before January 1, 2018. (Specified foreign corporations that are not CFCs are treated a CFCs solely for purposes of the §965 tax.) The United States shareholder will include its pro rata share of the foreign corporation's post-1986 deferred foreign income in its tax year with which or within which the last tax year of the specified foreign corporation beginning before January 1, 2018, ends.

To give an example, assume you have a calendar year United States shareholder and a specified foreign corporation with a November 30 tax year. The specified foreign corporation's last tax year beginning before January 1, 2018, is the year ending November 30, 2018. The tax year of the United States shareholder with which or within which the specified foreign corporation's November 30, 2018, year ends is its 2018 tax year. So the United States shareholder will be subject to the §965 tax for its 2018 tax year. [IRC §965; Act §14103; 930 T.M., IX.]

3. Is the §965 transition tax applicable only to ownership in CFCs, or does it apply to any foreign corporation in which a U.S. shareholder owns 10% or more?

It applies to any United States shareholder (as that term is defined for purposes of the CFC rules) of a foreign corporation in which a domestic corporation owns 10% or more by vote (applying the §958 attribution rules that are applicable to CFCs). This has some odd results. If a foreign corporation is not a CFC, but 10% or more of its voting shares are owned by a domestic corporation, an individual United States shareholder that also owns 10% or more of the foreign corporation's voting shares can be impacted by the tax. The reason for this is that 1) the foreign corporation is a specified foreign corporation because it has a 10% or greater domestic corporation as a shareholder, and 2) the individual is a United States shareholder as that term is defined for purposes of the CFC rules. [IRC §965; Act §14103; 930 T.M., IX.]

4. Is a §962 election necessary for individuals subject to the transition tax? Can individuals take distributions with no additional federal income tax?

Due to a quirk in the drafting of the language, individuals are subject to different rates than corporations on the §965 tax. For individuals with a 2017 inclusion year, the applicable rates are approximately 17.5% to the extent of the shareholder's aggregate foreign cash position, and 9% on all other earnings. For individuals with a 2018 inclusion year, the applicable rates are approximately 27.3% and 14.1%.

A §962 election would have the effect of treating the individual as a corporation for purposes of the applicable rate, reducing those rates to the 15.5% and 8% rates applicable to corporations. It would also permit such taxpayers to take advantage of foreign tax credits for foreign taxes paid by the foreign corporation with respect to the earnings

subject to the tax. However, §962 imposes a second level of tax when the earnings that were subject to the §965 tax are paid to the individual as a distribution; those earnings are required to be included in the taxpayer's income to the extent they exceed the U.S. federal income tax already paid on such earnings. As a result, an individual may not be in a better position making the §962 election, particularly if the individual is in a high tax bracket and the foreign corporation does not have a high effective rate of foreign tax. [IRC §962, §965; Act §12001(b)(15), §14103; 930 T.M., V. and IX.]

5. In the event a U.S. person wants to revoke the 8-year election to pay the §965 transition tax (for example, for tax planning in their foreign country, it may be beneficial to pay the §965 tax in the current year), is the election revocable?

There is no apparent mechanism in the statute for revoking the election. However, the only consequence of revoking the election would be that the taxpayer would be required to pay the tax on an accelerated schedule, and it difficult to see how the IRS would object to that. [IRC §965; Act §14103; 930 T.M., IX.]

6. If an LLC owns a foreign corporation subject to the transition tax, does the LLC pay the transition tax or does the tax flow to the LLC members?

I am assuming for purposes of this question that the LLC has not elected to be treated as a corporation for U.S. tax purposes. If that is the case, the amount required to be included in the LLC's income by §965 would flow through to the LLC members, and they would be required to pay the tax. [IRC §965; Act §14103; 930 T.M., IX.]

INDIVIDUALS

Deductions

1. Are property taxes prepaid in 2017 for the 2018 tax year properly deductible?

The total amount of state and local income and property taxes deductible by individuals is limited to $10,000 per year for tax years beginning after December 31, 2017, but before January 1, 2026. While cash basis taxpayers generally take deductions in the year an amount is paid, the IRS has taken the position that prepaid real property taxes may be deductible in 2017 only if assessed and paid in 2017. According to the IRS, anticipated real property taxes that were paid in 2017 but were not assessed until 2018 are not deductible in 2017. [I.R.C. §164; Act §11042; 525 T.M., II.A.; IR-2017-210 .]

2. Are state or local income taxes prepaid in 2017 for the 2018 tax year properly deductible?

The total amount of state and local income and property taxes deductible by individuals is limited to $10,000 per year for tax years beginning after December 31, 2017, but before January 1, 2026. While cash basis taxpayers generally take deductions in the year an amount is paid, in this case the 2017 tax act specifically provides that an amount paid in a tax year beginning before January 1, 2018, with respect to a state or local income tax imposed for a tax year beginning after December 31, 2017, is treated as paid on the last day of the tax year for which the tax is imposed. [I.R.C. §164; Act §11042; 525 T.M., II.A.]

3. Will an individual be able to deduct state and local taxes for the net investment income tax (NIIT) tax calculation above the $10,000 Schedule A limitation? Or will this be limited to $10,000 maximum?

The 2017 tax act added §164(b)(6) to limit an individual's deduction of state and local taxes to $10,000 per year for tax years 2018 through 2025. Section 1411(c)(1)(B) limits deductions allowable in computing NIIT to "the deductions allowed by this subtitle which are properly allocable to such gross income or net gain." Any state and local tax in

excess of the $10,000 limit would not be "allowed by this subtitle," i.e., Subtitle A. Accordingly, it appears that an individual will not be allowed to deduct state and local taxes for the NIIT tax calculation above the $10,000 limitation. [I.R.C. §164, §1411; Act §11042; 511 T.M., V.]

4. Are moving expenses deductible?

The deduction for moving expenses is suspended for tax years beginning after December 31, 2017, but before January 1, 2026. However, this deduction remains available for active duty members of the Armed Forces who move pursuant to a military order and incident to a permanent change of station. Additionally, the exclusion from income for reimbursement of moving expenses by an employer is also suspended, again with the exception for certain members of the Armed Forces. [I.R.C. §132, §217; Act §11048, §11049; 594 T.M., III.A.]

5. If an individual taxpayer directly owns rental real estate, does the $10,000 state and local property and income tax limitation apply?

The $10,000 limitation does not apply to property taxes paid or accrued in a trade or business or a §212 activity. The exception to the limitation does not apply to income taxes. [I.R.C. §164(b)(6); Act §11042; 525 T.M., II.A.]

Compensation and Benefits

1. Are existing contractual arrangements exempt from the changes to §162(m) that, among other things, eliminate the prior exception for performance-based compensation from the $1 million deduction limit on executive compensation paid by publicly held corporations?

The 2017 tax act eliminated the exceptions for commissions and performance-based compensation from the definition of compensation for purposes of applying the $1 million deduction limitation. Thus, these types of compensation are taken into account in determining the amount of compensation with respect to a covered employee for a tax year that exceeds $1 million. Although these changes are generally applicable for tax years beginning after December 31, 2017, payments made pursuant to a plan are grandfathered if the right to participate in the plan is part of a written binding contract with the covered employee in effect on November 2, 2017, and the plan is not materially modified on or after that date. If payments are grandfathered under this rule they are subject to the §162(m) rules in effect before enactment of the 2017 tax act. [I.R.C. §162(m); Act §13601; 390 T.M., X.B.]

For additional information, see Brigen Winters, Daniel Hogans, and William Fogleman, "Tax Reform Changes to § 162(m) Impact Executive Pay at Public Companies," 46 Compensation Plan. J. 23 (Feb. 2, 2018).

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