ROUNDUP OF RECENT TAX DEVELOPMENTS

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I. TAX CUTS AND JOBS ACT (H.R. 1).

On December 22, 2017, President Donald Trump signed the Tax Cuts and Jobs Act (TCJA) into law. The TCJA represents the most comprehensive reform to the U.S. tax code in over thirty years and takes effect January 1, 2018.

A. Introduction.

1. Domestic Business provisions.

a. Corporate Rate. The centerpiece of TCJA is the permanent reduction in the corporate income tax rate from 35% to 21%. The rate reduction would generally take effect on January 1, 2018. Special rules would provide fiscal-year filers with a blended tax rate for their tax year straddling January 1, 2018.

b. Corporate AMT. TCJA repeals the corporate AMT.

c. Expensing. TCJA temporarily introduces expensing as the principal capital cost recovery regime, increasing the 168(k) first-year "bonus" depreciation deduction to 100% and allowing taxpayers to write off immediately the cost of acquisitions of plant and equipment. This expensing regime would go further than current law bonus depreciation by applying to both new and used property. The 100% bonus depreciation rule would apply through 2022, and then would ratably phase down over the succeeding five years.

d. Temporary Deduction against Business Income Earned by Pass-through entities. TCJA adopts a provision which would permit certain non-corporate owners (i.e., owners who are individuals, trusts, or estates) of certain partnerships, S corporations and sole proprietorships to claim a 20% deduction against qualifying business income. TCJA includes numerous limitations on the income eligible for the deduction, with the apparent goal of treating compensation for services as ordinary income that is not eligible for the special deduction. Importantly, the deduction against qualifying income would expire for tax years beginning after December 31, 2025.

e. Revenue-Raising Provisions. To partially offset the cost of these tax benefits, TCJA would repeal or modify a number of existing provisions in the tax law such as the following:

- Repeals the section 199 domestic manufacturing deduction (beginning in 2018).
- Limits the deductibility of net business interest expense to 30% of adjusted taxable income. This provision would start with a broader definition of adjusted taxable income, but would significantly narrow that definition beginning in 2022.
- Limits the carryover of net operating losses to 80% of taxable income and eliminate the carryback (with special rules for certain insurance and farming businesses),

generally effective for losses arising in tax years beginning after 2017.

- Narrows the scope of the rules relating to contributions to capital (without repealing current section 118 as was proposed in the House bill).
- Modifies the deductibility of business entertainment expenses.
- Provide significant changes for taxation of the insurance industry.
- Require certain research or experimental (R&E) expenditures to be capitalized beginning in 2022.

2. Multinational entity taxation.

a. Territorial Tax Regime. TCJA shifts from the current system of worldwide taxation with deferral to a "participation exemption regime" with current taxation of certain foreign income. A "participation exemption" is a general term relating to an exemption from taxation for a shareholder in a company on dividends received, and potential capital gains arising on the sale of shares. Participation exemptions are what create a territorial tax system. Territorial systems tax businesses only on income earned within a country's borders. It applies to all businesses that operate within a country's boundaries, whether that business is headquartered in that country or another. To implement a "participation exemption regime," TCJA adopts several features, including:

i. A 100% deduction for dividends received from 10%-owned foreign corporations;

ii. A minimum tax on "global intangible low-taxed income" (GILTI); and

iii. As a transition to the new regime, deemed repatriation of previously untaxed "old earnings." A 15.5% rate would apply to earnings attributable to liquid assets and an 8% rate would apply to earnings attributable to illiquid assets.

b. Anti-base Erosion Measures. TCJA adopts certain anti-base erosion measures. Notably, TCJA adopts what it calls a "Base Erosion Anti-Abuse Tax" (BEAT). The BEAT generally imposes a minimum tax on certain deductible payments made to a foreign affiliate, including payments such as royalties and management fees, but excluding the cost of goods sold. The BEAT generally would apply to certain payments paid or accrued in tax years beginning after December 31, 2017.

c. Other Provisions.

i. TCJA includes several other provisions targeted at cross-border transactions, including revised treatment of hybrids, a new special deduction for certain foreign-derived intangible income, and rules for outbound transfers of intangibles.

ii. TCJA does not, however, include the House and Senate proposals to add a new section 163(n) to the Code to limit the amount of interest a domestic corporation can deduct to a measure of its proportionate share of the worldwide group's external indebtedness.

3. Individual Provisions - Sunset after 2025.

a. Sunset.

i. Many of the changes affecting individual taxpayers (including the deduction for certain owners of pass-through businesses) would cease to apply after December 31, 2025, and would revert to their pre-2018 form. Future legislation would be required to make the provisions effective beyond 2025.

ii. The 2025 sunset would not apply to TCJA's repeal of the Affordable Care Act's individual shared responsibility payment (the individual mandate) or the substitution of a new, lower inflation index for individual rate brackets.

b. Brackets. TCJA retains seven tax brackets but would modify the "breakpoints" for the brackets and reduce the rate for the top bracket to 37%. The temporary new brackets would be 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The top rate would apply to single filers with income over $500,000 and married joint filers with income over $600,000.

c. Standard Deduction. The standard deduction is temporarily increased to $24,000 for joint filers and $12,000 for individual filers, with these deductions indexed annually. At the same time, the deduction for personal exemptions is repealed, while the child tax credit is enhanced and the phase-out thresholds are substantially increased.

d. Revenue Offsets. The revenue cost of these changes is offset by temporarily modifying or eliminating a number of tax preferences. These include capping the home mortgage interest deduction to interest expenses attributable to mortgage balances no greater than $750,000 (for mortgages incurred December 15, 2017 or later), elimination of deductions for home equity loan interest, and, most significantly, capping the deduction for state and local taxes at $10,000. The "Pease" limitation, named after the late Congressman Donald Pease, which reduces the value of itemized deductions for high income taxpayers, is repealed.

4. Estate and Gift Tax. The estate, GST, and gift tax exemption amounts are doubled to $10 million (indexed for inflation) through 2025. TCJA does not

incorporate a House proposal to repeal the gift and estate tax. For 2018, this means the exemption is $11.2 million.

5. Affordable Care Act Modifications – "Individual Mandate." TCJA effectively repeals the individual mandate in the Patient Protection and Affordable Care Act by reducing the individual responsibility payment under section 5000A to zero for individuals who do not purchase health insurance that qualifies as minimum essential coverage, starting in 2019.

6. Taxation of investment income. The tax rates for capital gains and dividends are left unchanged. Also left unchanged is the net investment income tax. A Senate proposal to generally eliminate the ability of most taxpayers to use the specific identification method to identify the cost of any specified security sold, exchanged or otherwise disposed of was not included in TCJA.

7. Exempt organizations. TCJA makes several changes that are relevant to exempt organizations:

a. Imposes an excise tax on compensation in excess of $1 million and on "excess parachute payments" paid to certain employees of exempt organizations.

b. Imposes a 1.4% excise tax on the investment income earned by private colleges and universities with large endowments.

c. Requires unrelated business taxable income to be computed separately for each trade or business.

d. Increases unrelated business taxable income by the amount of certain fringe benefit expenses for which deductions are disallowed.

TCJA does not include a number of notable provisions that were in the House bill (e.g., uniform rate for the excise tax on private foundation net investment income and a provision allowing section 501(c)(3) organizations to engage in de minimis political activity).

B. <u>Individuals</u>.

1. Individual Tax Rates.

Rate	Single	HoH	Joint
10% >	$0	$0	$0
12% >	$9,525	$13,600	$19,050
22% >	$38,700	$51,800	$77,400
24% >	$82,500	$82,500	$165,000
32% >	$157,500	$157,500	$315,000
35% >	$200,000	$200,000	$400,000
37% >	$500,000	$500,000	$600,000

a. The individual income tax rates are indexed to the Chained CPI measure of inflation. Chained CPI would generally result in smaller annual increases to indexed amounts and was estimated by the JCT to increase revenues by approximately $134 billion over 10 years. The change to chained CPI for inflation indexing would be effective for tax years beginning after 2017 and would remain in effect after 2025. It is not subject to the sunset provision that applies to other individual provisions.

b. TCJA eliminates the discrepancy in income thresholds between a head of household filer and a single individual for all income subject to the 24% rate and above.

c. TCJA eliminates the so-called "marriage penalty" in all but the highest tax brackets, and thus would also remove much of the disadvantage of the married filing separate filing status.

2. Estate & Trust Tax Rates.

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

3. Filing Status, Standard Deductions, and Personal Exemptions.

a. TCJA retains the filing statuses available to taxpayers under current law:

- Single
- Married filing jointly
- Married filing separately
- Head of household
- Qualifying widow(er) with dependent child

b. TCJA imposes due diligence requirements for paid preparers in determining eligibility for a taxpayer to file as head of household and a $500 penalty each time a paid preparer fails to meet these requirements.

C. Under TCJA, the standard deduction in 2018 would be $12,000 for a taxpayer filing as single or married filing separately, $18,000 for a taxpayer filing as head of household, and $24,000 for taxpayers filing as married filing jointly (and surviving spouses). These amounts would be adjusted for inflation for tax years beginning after December 31, 2018 and would sunset after December 31, 2025.

4. Child Tax and Qualifying Dependents Credits.

a. Through tax year 2025, TCJA increases the child tax credit to $2,000 per qualifying child from the current credit of $1,000 per qualifying child. TCJA also temporarily provides a $500 nonrefundable credit for qualifying dependents other than qualifying children.

b. Under TCJA, $1,400 of the child tax credit is refundable. The refundable portion is indexed for inflation in future years using an indexing convention that rounds the $1,400 amount to the next lowest multiple of $100. The adjusted gross income levels at which this credit is subject to phase-out increases from $110,000 to $400,000 for joint filers, and from $75,000 to $200,000 for single filers (these thresholds are not indexed for inflation). Additionally, the earned income threshold for the refundable child tax credit is lowered from $3,000 under current law to $2,500. This threshold is not indexed for inflation.

c. TCJA requires the taxpayer to provide a social security number for each qualifying child for whom the credit is claimed on the tax return. This requirement does not apply to the $500 non-refundable credit for a non-child dependent. A qualifying child who is ineligible to receive the child tax credit due to not having a SSN is still eligible for the non-refundable $500 credit, including children with an Individual Taxpayer Identification Number rather than a Social Security Number.

5. Capital Gains and Dividends.

a. TCJA keeps in place the current system whereby net capital gains and qualified dividends are generally subject to tax at a maximum rate of 20% or 15%, with higher rates for gains from collectibles and unrecaptured depreciation.

b. TCJA retains the same "breakpoints" for these rates as under current law, except the breakpoints would be adjusted for inflation after 2018. For 2018, the 15% breakpoint would be $77,200 for married taxpayers filing jointly, $51,700 for head of household filers and $38,600 for all other filers. The 20% breakpoint would be $479,000 for married taxpayers filing jointly, $452,400 for head of household filers, and $425,800 for all other filers.

c. TCJA also leaves in place the current 3.8% net investment income tax.

6. Taxes (including SALT) not Paid or Accrued in a Trade or Business.

a. Under TCJA, itemized deductions for state and local income taxes, state and local property taxes, and sales taxes are limited to $10,000 in the aggregate (not indexed for inflation).

b. This cap does not apply if the taxes are incurred in carrying on a trade or business or otherwise incurred for the production of income.

c. In addition, foreign real property taxes, other than those incurred in a trade or business, would not be deductible.

d. The effective date would be for tax years beginning after December 31, 2017 and beginning before January 1, 2026.

7. Home Mortgage Interest and Home Equity Debt.

a. For tax years 2018 through 2025, TCJA limits the deduction available for mortgage interest on a taxpayer's principal residence and a second qualifying residence by reducing the amount of debt that can be treated as acquisition indebtedness from the current level of $1 million to $750,000.

b. TCJA further suspends the deduction for interest on home equity indebtedness for tax years 2018 through 2025.

c. Debt incurred before December 15, 2017, is "grandfathered." Any debt incurred before December 15, 2017, but refinanced later, would continue to be covered by current law to the extent the amount of the debt does not exceed the amount refinanced.

8. Charitable Contributions.

a. TCJA increases the adjusted gross income limitation for charitable contributions of cash made by individuals to public charities and certain private foundations to 60% from the current 50% limitation.

b. This applies to contributions made in tax years beginning after December 31, 2017 and before January 1, 2026.

9. Personal Casualty and Theft Losses.

a. Under current law, a deduction may be claimed for any loss sustained during the tax year that is not compensated by insurance or otherwise, subject to certain limitations. TCJA temporarily limits the deduction for personal casualty and theft losses to losses incurred in a federally-declared disaster.

b. The effective date would be for losses incurred in tax years beginning after December 31, 2017 and before January 1, 2026.

10. Miscellaneous Itemized Deductions Subject to the 2% Floor. TCJA suspends all miscellaneous itemized deductions that are subject to the 2% floor for years 2018-2025. The effective date would be for tax years beginning after December 31, 2017.

11. Overall Limitation on Itemized Deductions ("Pease" Limitation). Under current law, the total amount of allowable itemized deductions (with the exception of medical expenses, investment interest, and casualty, theft or gambling losses) is reduced by 3% of the amount by which the taxpayer's adjusted gross income

exceeds a threshold amount (referred to as the “Pease” limitation). TCJA suspends the overall limitation on itemized deductions for years 2018-2025. The effective date would be for tax years beginning after December 31, 2017.

12. Qualified Bicycle Commuting Reimbursement. Current law excludes up to $20 a month in qualified bicycle commuting reimbursement from an employee’s gross income. TCJA suspends this exclusion for years 2018 through 2025 such that any reimbursement of this expense would be taxable.

13. Exclusion for Qualified Moving Expense Reimbursements. TCJA suspends the exclusion from gross income and wages for qualified moving expense reimbursements received from an employer for years 2018 through 2025. The exclusion would be preserved for U.S. Armed Forces members (and family members).

14. Deduction for Moving Expenses. Under current law, individuals are permitted an above-the-line deduction for moving expenses paid or incurred in connection with starting work either as an employee or as a self-employed individual at a new principal place of work. TCJA suspends the deduction for moving expenses for years 2018 through 2025. However, the rules providing targeted income exclusion for moving and storage expenses furnished in kind to members of the U.S. Armed Forces (or their spouse or dependents) would be retained.

15. Wagering Losses. Under current law, losses sustained on wagering transactions are allowed as a deduction only to the extent of gains from wagering. TCJA clarifies that “losses from wagering transactions” includes any deduction otherwise allowable that is incurred in carrying on any wagering transaction. Thus, the limitation on losses from wagering transactions would apply to the actual costs of wagers incurred by an individual, and to other expenses incurred in connection with the conduct of the gambling activity. For instance, an individual’s otherwise deductible expenses in traveling to or from a casino are subject to the limitation. The provision would be effective for tax years beginning after December 31, 2017 (subject to a December 31, 2025 sunset).

16. Alternative Minimum Tax (AMT). TCJA temporarily increases the AMT exemption amounts and the phase out thresholds for individuals:

a. For married taxpayers filing a joint return (or for a surviving spouse), the AMT exemption amount for 2018 would be increased from $86,200 under current law to $109,400. The phase out threshold is increased from $164,100 to $1,000,000.

b. For married taxpayers filing a separate return, the AMT exemption amount would be increased from $43,100 (under current law for 2018) to $54,700. The phase out threshold is increased from $82,050 to $500,000.

c. For all other individual taxpayers, the exemption amount for 2018 under current law is $55,400. TCJA raises this amount to $70,300. The phase out threshold is increased from $123,100 to $500,000.

d. The increased exemption amounts and phase out thresholds sunset after December 31, 2025.

17. Medical Expense Deduction Floor. Under TCJA, individuals are allowed to deduct qualified medical expenses in excess of 7.5% of adjusted gross income (AGI) for tax years 2017 and 2018 for regular tax and alternative minimum tax purposes. Under current law, the deduction is limited to medical expenses in excess of 10% of (AGI). After 2018, the 10% AGI threshold would be applicable.

18. ABLE Accounts.

a. Under TCJA, the overall limit on contributions to ABLE accounts would remain the same ($14,000 for 2017). However, after the limit is reached, the designated beneficiary could contribute an additional amount up to the lesser of the Federal poverty line for a one-person household as determined for the preceding calendar year, or the individual's compensation for the tax year. The designated beneficiary could claim the saver's credit for contributions to the ABLE account. This provision sunsets after December 31, 2025.

b. TCJA also provides that amounts from qualified tuition programs under section 529 could be rolled over to an ABLE account without penalty provided that the ABLE account was owned by the designated beneficiary of the 529 account or a member of the designated beneficiary's family. The rollover would count towards the overall limitation on amounts that can be contributed to an ABLE account in a tax year. Amounts in excess of the limit would be included in income as provided under section 72. This provision sunsets after December 31, 2025.

19. Combat Zone Tax Benefits to Armed Forces in Sinai Peninsula of Egypt. TCJA grants combat zone tax benefits to Armed Forces members performing services in the Sinai Peninsula of Egypt, generally effective June 9, 2015. "Special pay" benefits include limited gross income and excise tax exclusions, surviving spouse benefits, and filing extensions. This provision sunsets after 2025.

20. Discharge of Student Debt. TCJA excludes any income resulting from the discharge of student debt due to death or disability. The exclusion would apply to discharges of loans after December 31, 2017 and before January 1, 2026.

21. 529 Plans.

a. Under current law, earnings from 529 plans are not currently taxable for federal purposes and distributions are not taxable for federal purposes so long as the distributions are used for qualified higher education expenses such as tuition and room and board as well as fees, books, supplies, and equipment required for enrollment.

b. TCJA expands the definition of qualified higher education expenses to include public, private, and religious elementary and secondary schools.

c. TCJA also limits the tax-free distribution amount to an aggregate of $10,000 per student per year when used for expenses with respect to elementary and secondary schools. The $10,000 per student per year limitation does not apply to distributions for post-secondary school expenses.

d. The provision is effective for distributions made after December 31, 2017 and is not subject to a sunset clause.

22. Alimony Payments.

a. Under current law, alimony and separate maintenance payments are deductible by the payor spouse and includible in income by the payee spouse.

b. Under TCJA, alimony and separate maintenance payments are not deductible by the payor spouse and are not be includible in the income of the payee spouse.

c. The effective date of this provision is delayed by one year. Thus, it would be effective for any divorce or separation agreement executed after December 31, 2018, and for any agreement executed before but modified after that date if the modification expressly provides that this new provision applies to such modification.

23. Excluded House and Senate Proposals. Several House and Senate proposals are not included in TCJA. As a result, individuals would remain subject to tax under the provisions currently provided in the Code:

- Exclusion of gain on the sale of a principal residence;
- Exclusion for employer-provided housing;
- Exclusion for dependent care assistance programs;
- Exclusion for educational assistance programs;
- Exclusion for adoption assistance programs; and
- Deduction for educator expenses.

C. <u>Businesses</u>.

1. Corporate Tax Rates. For tax years beginning after December 31, 2017, the corporate tax rate is a flat 21% rate.

2. Dividends-Received Deduction. For tax years beginning after Dec. 31, 2017, the 80% dividends received deduction is reduced to 65%, and the 70% dividends received deduction is reduced to 50%.

3. Corporate AMT. TCJA repeals the corporate AMT effective for tax years beginning after December 31, 2017. Any AMT credit carryovers to tax years after that date generally can be utilized to the extent of the taxpayer's regular tax liability (as reduced by certain other credits). In addition, for tax years beginning in 2018, 2019, and 2020, to the extent that AMT credit carryovers exceed regular tax liability (as reduced by

certain other credits), 50% of the excess AMT credit carryovers would be refundable (a proration rule would apply with respect to short tax years). Any remaining AMT credits would be fully refundable in 2021.

4. Section 179 Expensing. The section 179 expensing election is modified to increase the maximum amount that can be deducted to $1 million (up from $500,000 under present law) (the "dollar limit"). The dollar limit is reduced dollar-for-dollar to the extent the total cost of section 179 property placed in service during the tax year exceeds $2.5 million (up from $2 million under present law) (the "phase-out amount"). These limits are adjusted annually for inflation. The changes are effective for property placed in service in tax years beginning after 2017.

a. The definition of Code Sec. 179 property is expanded to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging.

b. The definition of qualified real property eligible for Code Sec. 179 expensing is also expanded to include the following improvements to nonresidential real property after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

5. Temporary 100% Cost Recovery.

a. A 100% first-year deduction for the adjusted basis is allowed for qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023. For certain property with longer production periods, the beginning and end dates in the list above are increased by one year. In later years, the first-year bonus depreciation deduction phases down, as follows:

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

b. The proposed regulations (REG-104397-18) include rules on elections to skip bonus depreciation entirely or to take only 50 percent bonus depreciation. While the statute would allow the former election to be made for each class of property, without similar language in the statutory provision for the latter election the IRS and Treasury propose to allow it to apply only to all qualified property.

c. While the provisions in the new bonus depreciation regulations will be mandatory once they are finalized, until that happens the proposed regulations allow that "a taxpayer may choose to apply these proposed regulations to qualified property acquired and placed in service or planted or grafted, as applicable, after September 27, 2017, by the taxpayer during taxable years ending on or after September 28, 2017."

6. Luxury Automobile Depreciation. For passenger automobiles placed in service after December 31, 2017, in tax years ending after that date, for which the additional first-year depreciation deduction under Code Sec. 168(k) is not claimed, the maximum amount of allowable depreciation is increased to: $10,000 for the year in which the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years in the recovery period. For passenger automobiles placed in service after 2018, these dollar limits are indexed for inflation. For passengers autos eligible for bonus first-year depreciation, the maximum first-year depreciation allowance remains at $8,000.

7. Recovery Period for Real Property. The cost recovery periods for most real property are currently 39 years for nonresidential real property and 27.5 years for residential rental property. Under TCJA, the straight line depreciation method and mid-month convention are required for such real property. For property placed in service after December 31, 2017, the separate definitions of qualified leasehold improvement, qualified restaurant, and qualified retail improvement property are eliminated, a general 15-year recovery period and straight-line depreciation are provided for qualified improvement property, and a 20-year ADS recovery period is provided for such property.

8. Deduction of Business Interest.

a. For tax years beginning after December 31, 2017, every business, regardless of its form, is generally subject to a disallowance of a deduction for net interest expense in excess of 30% of the business's adjusted taxable income. The net interest expense disallowance is determined at the tax filer level. However, a special rule applies to pass-through entitles, which requires the determination to be made at the entity level, for example, at the partnership level instead of the partner level.

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

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

d. An exemption from these rules applies for taxpayers (other than tax shelters) with average annual gross receipts for the three-tax year period ending with the prior tax year that do not exceed $25 million. Real property trades or businesses can elect out of the provision if they use ADS to depreciate applicable real property used in a trade or business. An exception from the limitation on the business interest deduction is also provided for floor plan financing.

e. Partnerships.

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

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

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

9. Net Operating Loss Deduction. Under pre-TCJA law, a net operating loss (NOL) may generally be carried back two years and carried over 20 years to offset taxable income in such years. For NOLs arising in tax years ending after December 31, 2017, the two-year carryback is repealed, except in the case of certain losses incurred in the trade or business of farming. For losses arising in tax years beginning after December 31, 2017, the NOL deduction is limited to 80% of taxable income (determined without regard to the deduction), but can be carried forward indefinitely.

10. Domestic Production Activities Deduction. For tax years beginning after December 31, 2017, the domestic production activities deduction is repealed.

11. Like-Kind Exchange Treatment. Effective for transfers after December 31, 2017, the rule allowing the deferral of gain on like-kind exchanges is modified to allow for like-kind exchanges only with respect to real property that is not held primarily for sale.

12. Research or Experimentation (R&E) Expenses. Under pre-TCJA law, taxpayers may elect to deduct currently the amount of certain reasonable research or experimentation (R&E) expenses paid or incurred in connection with a trade or business. Alternatively, taxpayers may forgo a current deduction, capitalize their research expenses, and recover them ratably over the useful life of the research, but in no case over a period of less than 60 months. Or, they may elect to recover them over a period of 10 years. For amounts paid or incurred in tax years beginning after December 31, 2021, "specified R&E expenses" must be capitalized and amortized ratably over a 5-year period (15 years if conducted outside of the U.S.), beginning with the midpoint of the tax year in which the specified R&E expenses were paid or incurred.

13. Fringe Benefit Expenses.

a. For amounts incurred or paid after December 31, 2017, deductions for entertainment expenses are disallowed.

b. The current 50% limit on the deductibility of business meals is expanded to meals provided through an in-house cafeteria or otherwise on the premises of the employer.

c. Deductions for employee transportation fringe benefits (e.g., parking and mass transit) are denied.

d. The exclusion from income for transportation fringe benefits received by an employee is retained.

e. No deduction is allowed for transportation expenses that are the equivalent of commuting for employees (e.g., between the employee's home and the workplace), except as provided for the safety of the employee.

f. For tax years beginning after December 31, 2025, TCJA will disallow an employer's deduction for expenses associated with meals provided for the convenience of the employer on the employer's business premises, or provided on or near the employer's business premises through an employer-operated facility.

14. Nondeductible Penalties and Fines.

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

b. Under TCJA, beginning December 22, 2017, no deduction is allowed for any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or specified nongovernmental entity in connection

with the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law.

c. An exception applies to payments that the taxpayer establishes are either restitution (including remediation of property) or amounts required to come into compliance with any law that was violated or involved in the investigation or inquiry, that are identified in the court order or settlement agreement as restitution, remediation, or required to come into compliance. IRS remains free to challenge the characterization of an amount so identified; however, no deduction is allowed unless the identification is made.

d. Restitution for failure to pay any tax, that is assessed as restitution under the Code is deductible only to the extent it would have been allowed as a deduction if it had been timely paid.

15. Amounts Paid for Sexual Harassment Subject to Nondisclosure Agreement. Effective for amounts paid or incurred after December 22, 2017, no deduction is allowed for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if such payments are subject to a nondisclosure agreement.

16. Employee Achievement Awards. Employee achievement awards are excludable to the extent the employer can deduct the cost of the award - - generally limited to $400 for any one employee, or $1,600 for a “qualified plan award.” An employee achievement award is an item of tangible personal property given to an employee in recognition of either length of service or safety achievement and presented as part of a meaningful presentation. For amounts paid or incurred after December 31, 2017, a definition of “tangible personal property” is provided. Tangible personal property does not include cash, cash equivalents, gifts cards, gift coupons, gift certificates (other than where from the employer pre-selected or pre-approved a limited selection) vacations, meals, lodging, tickets for theatre or sporting events, stock, bonds or similar items, and other non-tangible personal property. No inference is intended that this is a change from present law.

17. Excessive Employee Compensation. A deduction for compensation paid or accrued with respect to a covered employee of a publicly traded corporation is limited to no more than $1 million per year. However, under pre-TCJA law, exceptions applied for: (i) commissions; (ii) performance-based remuneration, including stock options; (iii) payments to a tax-qualified retirement plan; and (iv) amounts that are excludable from the executive's gross income. Under TCJA, for tax years beginning after December 31, 2017, the exceptions to the $1 million deduction limitation for commissions and performance-based compensation are repealed. The definition of “covered employee” is revised to include the principal executive officer, the principal financial officer, and the three other highest paid officers. If an individual is a covered employee with respect to a corporation for a tax year beginning after December 31, 2016, the individual remains a covered employee for all future years.

18. Contributions to Capital. Effective December 22, 2017, TCJA provides that the term “contributions to capital” does not include (i) any contribution in

aid of construction, (ii) any contribution from a customer or potential customer, and (iii) any contribution by a governmental entity or civic group (other than a contribution made by a shareholder as such). These modifications to section 118 generally would require corporations to include the specified types of contributions in gross income.

19. Rehabilitation Credit. Under pre-TCJA law, a 20% credit is provided for qualified rehabilitation expenditures with respect to a certified historic structure, i.e., any building that is listed in the National Register, or that is located in a registered historic district and is certified by the Secretary of the Interior to the Secretary of the Treasury as being of historic significance to the district. A 10% credit is provided for qualified rehabilitation expenditures with respect to a qualified rehabilitated building, which generally means a building that was first placed in service before 1936. Straight-line depreciation or the ADS must be used in order for rehabilitation expenditures to be treated as qualified for the credit. Under TCJA, for amounts paid or incurred after December 31, 2017, the 10% credit for qualified rehabilitation expenditures with respect to a pre-'36 building is repealed and a 20% credit is provided for qualified rehabilitation expenditures with respect to a certified historic structure which can be claimed ratably over a 5-year period beginning in the tax year in which a qualified rehabilitated structure is placed in service.

20. Employer-Paid Family and Medical Leave. For wages paid in tax years beginning after December 31, 2017, but not beginning after December 31, 2019, the TCJA allows businesses to claim a general business credit equal to 12.5% of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave (FMLA) if the rate of payment is 50% of the wages normally paid to an employee. The credit is increased by 0.25 percentage points (but not above 25%) for each percentage point by which the rate of payment exceeds 50%. To qualify for the credit, all qualifying full-time employees have to be given at least two weeks of annual paid family and medical leave (all less-than-full-time qualifying employees have to be given a commensurate amount of leave on a pro rata basis).

D. Accounting Method Changes.

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

2. Cash Method of Accounting.

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

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

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

3. Accounting for Inventories. Under pre-TCJA law, businesses that are required to use an inventory method must generally use the accrual accounting method. However, the cash method can be used for certain small businesses that meet a gross receipt test with average gross receipts of not more than $1 million ($10 million businesses in certain industries). These businesses account for inventory as non-incidental materials and supplies. Under TCJA, for tax years beginning after December 31, 2017, taxpayers that meet the $25 million gross receipts test are not required to account for inventories under Code Sec. 471, but rather may use an accounting method for inventories that either (i) treats inventories as non-incidental materials and supplies, or (ii) conforms to the taxpayer's financial accounting treatment of inventories. Use of this provision results is a change in the taxpayer's accounting method for purposes of Code Sec. 481.

4. Capitalization and Inclusion of Certain Expenses in Inventory Costs. The uniform capitalization (UNICAP) rules generally require certain direct and indirect costs associated with real or tangible personal property manufactured by a business to be included in either inventory or capitalized into the basis of such property. However, under pre-TCJA law, a business with average annual gross receipts of $10 million or less in the preceding three years is not subject to the UNICAP rules for personal property acquired for resale. The exemption does not apply to real property (e.g., buildings) or personal property that is manufactured by the business. Under TCJA, for tax years beginning after December 31, 2017, any producer or re-seller that meets a $25 million gross receipts test is exempted from the application of Code Sec. 263A. The exemptions from the UNICAP rules that are not based on a taxpayer's gross receipts are retained. Use of this provision results is a change in the taxpayer's accounting method for purposes of Code Sec. 481.

5. Long-Term Contracts. Under pre-TCJA law, an exception from the requirement to use the percentage-of-completion method (PCM) for long-term contracts was provided for construction companies with average annual gross receipts of $10 million or less in the preceding three years. For contracts entered into after December 31, 2017 in tax years ending after that date, the exception for small construction contracts from the requirement to use the PCM is expanded to apply to contracts for the construction or improvement of real property if the contract: (i) is expected (at the time such contract is entered into) to be completed within two years of commencement of the contract and (ii) is performed by a taxpayer that (for the tax year in which the contract was entered into) meets a $25 million gross receipts test.

E. Pass-Through Entities.

1. Deduction for Pass-Through Income.

a. Deduction. For tax years beginning after December 31, 2017 (subject to a sunset at the end of 2025), TCJA generally allows an individual taxpayer (including a trust or estate) a deduction for 20% of the individual's domestic qualified business income from a partnership, S corporation, or sole proprietorship.

b. Limitation. The deduction is subject to a limit based either on wages paid or wages paid plus a capital element. Generally, the limitation is the greater of:

i. 50% of the W-2 wages paid with respect to the qualified trade or business; or

ii. The sum of 25% of the W-2 wages with respect to the qualified trade or business plus 2.5% of the unadjusted basis (determined immediately after an acquisition) of all qualified property.

**Item (ii) above, which was added to the bill in Conference, would, for example, benefit people who own businesses with large real estate holdings but have few actual employees.*

c. W-2 Wages.

i. A taxpayer's "W-2 wages" generally equal the sum of wages subject to wage withholding, elective deferrals, and deferred compensation paid by the partnership, S corporation, or sole proprietorship during the tax year.

ii. In the case of a trust or estate, rules similar to present law section 199 (as in effect on December 1, 2017) apply for purposes of apportioning between fiduciaries and beneficiaries any W-2 wages and unadjusted basis of qualified property.

iii. The 50% of wages limitation does not apply in the case of a taxpayer with income of $315,000 or less for married individuals filing jointly ($157,500 for other individuals), with phase-out over the next $100,000 of taxable income for married individuals filing jointly ($50,000 for other individuals). Thus, for 2018, the limit fully applies to married taxpayers with taxable income over $415,000 and other individuals with taxable income over $207,500.

d. Qualified Trade or Business.

i. A qualified business generally would be any trade or business other than a "specified service trade or business."

ii. A "specified service trade or business" is any trade or business activity involving the performance of services in the fields of health, law,

accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, any trade or business the principal asset of which is the reputation or skill of one or more of its owners or employees (excluding engineering and architecture), or any business that involves the performance of services that consist investment and investment managing trading or dealing in securities, partnership interest, or commodities.

iii. However, the deduction may apply to income from a specified service trade or business if the taxpayer's taxable income does not exceed $315,000 (for married individuals filing jointly or $157,500 for other individuals). This benefit is phased out over the next $100,000 of taxable income for married individuals filing jointly ($50,000 for other individuals).

e. Qualified Business Income.

i. An individual's qualified business income for the tax year would be the net amount of domestic qualified items of income, gain, deduction, and loss (determined by taking into account only items included in the determination of taxable income) with respect to the taxpayer's "qualified business."

ii. If the amount of qualified business income for a tax year were less than zero (i.e., a loss), the loss would be treated as a loss from qualified businesses in the next tax year.

iii. Twenty percent (20%) of any dividends from a real estate investment trust (other than any portion that is a capital gain dividend) would be qualified items of income, as would 20% of includable dividends from certain cooperatives and qualified publicly traded partnership income.

iv. However, qualified business income would not include certain service related income paid by an S corporation or a partnership.

A. Specifically, qualified business income would not include an amount paid to the taxpayer by an S corporation as reasonable compensation.

B. Further, it would not include a payment by a partnership to a partner in exchange for services (regardless of whether that payment is characterized as a guaranteed payment or one made to a partner acting outside his or her partner capacity).

C. Finally, qualified business income would not include certain investment related gain, deduction, or loss.

f. Qualified Property. Qualified property means tangible property of a character subject to depreciation that: (i) is held by, and available for use in, the qualified trade or business at the close of the tax year; (ii) is used at any point during the tax year in the production of qualified business income; and (iii) for which the depreciable period has not ended before the close of the tax year. "Depreciable period"

means the period beginning on the date the property is placed in service by the taxpayer and ending on the later of: (i) 10 years after that date; or (ii) the last day of the last full year in the applicable recovery period that would apply to the property under section 168 (without regard to section 168(g)).

g. Allowance. The 20% deduction is not allowed in computing adjusted gross income; instead, it is allowed as a deduction reducing taxable income. Thus, the deduction would not affect limitations based on adjusted gross income. Moreover, the deduction would be available to taxpayers that itemize deductions, as well as those that do not.

h. Accuracy Penalty. In the case of a taxpayer claiming the pass through business income deduction, TCJA lowers the threshold at which Section 6662 would apply an accuracy-related penalty on the grounds of a substantial understatement of tax. For such a taxpayer, a substantial understatement would exist if the amount of tax required to be shown on the return were to exceed the amount of tax actually shown on the return by the greater of 5 percent (rather than 10 percent) or $5,000.

i. Period of Effectiveness. The 20% deduction is effective for tax years beginning after December 31, 2017. However, it would cease to be available in tax years beginning after December 31, 2025, unless legislation were enacted extending it.

j. Proposed Regulations. The Treasury released proposed regulations under Section 199A on August 8, 2018.

i. W-2 Wage Limitation

- In conjunction with the issuance of the proposed regulations, the IRS issued Notice 2018-64, which in turn proposed a revenue procedure providing three allowable methods for calculating W-2 Wages.

- The proposed 199A regulations provide that W-2 Wages include not only wages paid by the individual, partnership or S corporation itself, but also wages paid by a third party to common-law employees of the individual, partnership or S corporation for employment by such person or entity.

ii. Unadjusted Basis Immediately after Acquisition

- For taxpayers with taxable income in excess of the Threshold, the section 199A deduction, with respect to any trade or business, may be subject to an alternative limitation based partly on W-2 wages and partly on the tax basis of property used in that trade or business. The basis component of the limitation is

generally determined with reference to the tax basis of qualified property on the date it is placed in service, without reduction for depreciation, section 179 expenses or adjustments for tax credits claimed (Unadjusted Basis Immediately after Acquisition or UBIA). The UBIA of qualified property may be included in the threshold until the later of 10 years after the property was placed in service or the end of the applicable recovery period for the property under Section 168.

- The regulations provide several clarifications in determining UBIA, including the treatment of property acquired in like-kind exchanges or involuntary conversions, property acquired in other nonrecognition transactions, and improvements to existing properties.

iii. Qualified Business Income

- Only qualified business income (QBI) is eligible for the section 199A deduction. QBI includes only items that are connected with the conduct of a trade or business within the United States and allowed in determining taxable income during the year.

- Where a taxpayer, partnership or S corporation conducts multiple trades or businesses, the proposed regulations provide that it must allocate the items comprising QBI among the various trades or businesses based on a reasonable and consistently applied method that clearly reflects the income and expense of each business.

iv. Aggregation Rules

- QBI, W-2 Wages and UBIA must be determined separately for each trade or business engaged in by the taxpayer. The resulting Section 199A deduction can be substantially affected by the way a taxpayer defines each trade or business. For this purpose, the proposed regulations allow, but do not require, the aggregation of trades or businesses, but only if the following requirements are met:

  - The same persons own 50% or more or each trade or business to be aggregated;

- The required common ownership exists for a majority of the taxable year;

- All of the items to be aggregated are reported on returns for the same taxable year;

- None of the trades or businesses are Specified Service Trades or Businesses (SSTBs); and

- At least two of the following factors are satisfied:

  - The trades or businesses provide products and services that are the same (for example, a restaurant and a food truck) or customarily offered together (for example, a gas station and a car wash);

  - The trades or businesses share facilities or significant centralized business elements (for example, common personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources);

  - The trades or businesses are operated in coordination with, or reliance upon one or more of the businesses in the group (for example, supply chain interdependencies).

- Once an individual chooses to aggregate two or more trades or businesses, that same taxpayer must continue to do so in subsequent taxable years unless there is a change in facts and circumstances such that the trades or businesses no longer qualify for aggregation. However, newly created or acquired businesses may be added to an existing group if the requirements for aggregation are met. Multiple owners of an RPE need not aggregate in the same manner.

v. Specified Service Trades or Businesses

- Taxpayers with taxable income in excess of the Threshold (subject to phase-in) may not claim a section 199A deduction with respect to income they receive from Specified Service Trades or Businesses (SSTBs). SSTBs are defined as any trade or business involving the performance of

services in the fields of health; law; accounting; actuarial science; performing arts; consulting; athletics; financial services; brokerage services; investing and investment management; trading; dealing in securities, partnership interests or commodities; 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.

- The proposed regulations provide definitions for each of the trades or businesses listed above. Several of those definitions place important limitations on their scope.

- For a trade or business with gross receipts of $25 million dollars or less for the taxable year, a trade or business is not an SSTB if less than 10 percent of the gross receipts of the trade or business are attributable to the performance of services in a specified field.

- A trade or business with gross receipts of greater than $25 million for the taxable year is not an SSTB if less than 5% of its gross receipts are attributable to the performance of services in a specified field.

- No income, W-2 Wages, or UBIA of an SSTB may be taken into account by any individual whose taxable income exceeds the Threshold (subject to phase-in), even if the item is derived from an activity that is not itself an SSTB.

- If the SSTB is conducted by an RPE, the limitation applies to each direct or indirect individual owner regardless of whether the owner is passive or participated in any SSTB activity.

- The proposed 199A regulations also provide that an SSTB includes any trade or business that provides 80% or more of its property or services to an SSTB if there is 50% or more common ownership of the trades or businesses. If the other trade or business provides less than 80% of its property or services to the commonly owned SSTB, then a proportionate share of the other business is considered part of the SSTB. This rule limits the ability of taxpayers to maximize the 199A

deduction by spinning off components of an SSTB's business (such as its real property) into a separate entity that does not conduct an SSTB.

vi. Other Clarifications

- The deduction is only available with respect to income from a trade or business, which does not include an investment activity. The proposed regulations clarify that for purposes of section 199A, the term "trade or business" is as defined in Section 162(a) with one exception: if a rental or licensing activity does not rise to the level of a trade or business (e.g., due to lack of sufficient business activity) it is treated as a trade or business if the property is rented or licensed to a trade or business that is commonly controlled.

- Where a taxpayer has multiple trade or business activities eligible for the deduction, the 199A deduction for each activity must generally be computed separately. The proposed regulations provide rules for netting losses from one activity against the income from other activities in determining the current year deduction and any net loss that must be carried over. The regulations also clarify that any carryover loss is treated as a loss from a separate trade or business in the following year in computing the section 199A deduction, but that the carryover does not affect the deductibility of the loss under other provisions of the internal revenue code.

- In the case of a partnership or S corporation, the deduction is determined at the partner or shareholder level. The regulations therefore clarify that any Section 199A deduction claimed by a partner or shareholder does not affect the taxpayer's basis in the partnership interest, the basis of their S corporation stock, or the shareholder's accumulated adjustments account.

- The regulations clarify that the Section 199A deduction does not affect the base for determining self-employment tax under Section 1402 or the tax on net investment income under Section 1411.

vii. Reporting Requirements

- The proposed regulations require partnerships, S corporations, PTPs, trusts and estates to provide their owners and beneficiaries with the information necessary to compute the Section 199A deduction.

- Generally, those entities must separately identify and report the following information on the Schedule K-1 issued to the owners for any trade or business engaged in directly by the RPE:

  - Each owner's allocable share of QBI, W-2 Wages and UBIA of qualified property attributable to each such trade or business;

  - Whether any of those trades or businesses are SSTBs;

  - Each owner's allocated share of any qualified REIT dividends or qualified PTP income or loss; and

  - Any such items reported to the RPE by any other RPE in which it owns a direct or indirect interest.

- If an entity fails to separately identify or report any such item, the owner's share (and the share of any upper-tier indirect owner) of positive QBI, W-2 wages, and UBIA of qualified property attributable to trades or businesses engaged in by that RPE will be presumed to be zero.

- Special reporting rules are also provided for PTPs, trusts and estates.

2. Partnership Technical Termination.

a. Under a "technical termination" under Code Sec. 708(b)(1)(B), a partnership is considered as terminated if, within any 12-month period, there is a sale or exchange of 50% or more of the total interest in partnership capital and profits. A technical termination gives rise to a deemed contribution of all the partnership's assets and liabilities to a new partnership in exchange for an interest in the new partnership, followed by a deemed distribution of interests in the new partnership to the purchasing partners and the other remaining partners. As a result of a technical termination, some of the tax attributes of the old partnership terminate, the partnership's

tax year closes, partnership-level elections generally cease to apply, and the partnership depreciation recovery periods restart.

b. Under TCJA, for partnership tax years beginning after December 31, 2017, the Code Sec. 708(b)(1)(B) rule providing for the technical termination of a partnership is repealed.

c. The repeal doesn't change the pre-TCJA law rule of Code Sec. 708(b)(1)(A) that a partnership is considered as terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

3. Sale of Partnership Interest.

a. Gain or loss from the sale or exchange of a partnership interest generally is treated as gain or loss from the sale or exchange of a capital asset. However, the amount of money and the fair market value of property received in the exchange that represents the partner's share of certain ordinary income-producing assets of the partnership give rise to ordinary income rather than capital gain.

b. A foreign person that is engaged in a trade or business in the U.S. is taxed on income that is “effectively connected” with the conduct of that trade or business (i.e., effectively connected gain or loss). Partners in a partnership are treated as engaged in the conduct of a trade or business within the U.S. if the partnership is so engaged.

c. For sales and exchanges on or after November 27, 2017, gain or loss from the sale or exchange of a partnership interest is effectively connected with a U.S. trade or business to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange. Any gain or loss from the hypothetical asset sale by the partnership must be allocated to interests in the partnership in the same manner as non-separately stated income and loss.

d. For sales, exchanges, and dispositions after December 31, 2017, the transferee of a partnership interest must withhold 10% of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that the transferor is not a nonresident alien individual or foreign corporation.

4. Partnership “Substantial Built-In Loss” Modified.

a. In general, a partnership does not adjust the basis of partnership property following the transfer of a partnership interest unless either the partnership has made a one-time election under Code Sec. 754 to make basis adjustments, or the partnership has a substantial built-in loss immediately after the transfer.

b. Under pre-TCJA law, a substantial built-in loss exists if the partnership's adjusted basis in its property exceeds by more than $250,000 the fair market value of the partnership property.

c. Under TCJA, for transfers of partnership interests after December 31, 2017, the definition of a substantial built-in loss is modified for purposes of Code Sec. 743(d), affecting transfers of partnership interests. In addition to the present-law definition, a substantial built-in loss also exists if the transferee would be allocated a net loss in excess of $250,000 upon a hypothetical disposition by the partnership of all partnership's assets in a fully taxable transaction for cash equal to the assets' fair market value, immediately after the transfer of the partnership interest.

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

6. Eligible Terminated S Corporations.

a. Background. TCJA contains two generally favorable provisions applicable to “eligible terminated S corporations.” The provisions appear to be based on an expectation that some S corporations may revoke their S corporation status if the conference agreement became law.

b. Eligible Terminated S Corporation. An eligible terminated S corporation is any C corporation:

i. That was an S corporation on the day before the date of enactment and revokes its S election in the two-year period beginning on the date of such enactment; and

ii. The owners of the stock of which (determined on the date on which such revocation is made) are the same and such owners hold the stock in the same proportions as on the date of enactment.

c. Accounting Method Changes.

i. In the case of an eligible terminated S corporation, any section 481 adjustment arising from an accounting method change attributable to the corporation’s revocation of its S corporation election will be taken into account ratably during the six tax year period beginning with the year of the method change.

ii. Thus, a corporation that must change a method of accounting as a result of the revocation of its S election would include any income resulting from that change over six tax years (as opposed to the four year period under current method change procedures).

iii. The IRS in Rev. Proc. 2018-44 has modified the automatic changes list in Rev. Proc. 2018-31 for accounting methods to reflect the new rules on adjustments that are attributable to revocations of S corporation elections under TCJA.

d. Distributions Following Conversion to C Corporation Status.

i. The second provision revises the treatment of distributions made by certain corporations following their conversion to C corporation status. Under current law, distributions by an S corporation generally are treated as coming first from the S corporation's accumulated adjustments account (AAA), which effectively measures the income of the S corporation that has been taxed to its shareholders but remains undistributed. If AAA is exhausted by the distribution, the excess distribution is treated as coming from any earnings and profits (E&P) of the corporation generated when it was a C corporation (or inherited from a C corporation under section 381). For a shareholder, distributions out of AAA generally are more favorable, as those distributions are tax-free to the extent of the shareholder's basis in its S corporation stock and then give rise to capital gain for the shareholder. In contrast, distributions out of E&P are treated as dividends and taxed accordingly.

ii. If a corporation's S election terminates, special rules apply to distributions made by the resulting C corporation during the post-transition termination period ("PTTP"). The PTTP begins on the day after the last day of the corporation's last tax year as an S corporation and generally ends on the later of: (i) the day that is one year after that day; or (ii) the due date for filing the return for such last year as an S corporation (including extensions). However, the PTTP may be extended in certain situations. A distribution of cash made by a C corporation with respect to its stock during the PTTP is applied against and reduces the shareholder's basis in the stock to the extent the amount of the distribution does not exceed the corporation's AAA. Thus, cash distributions by a former S corporation may be subject to the generally beneficial S corporation treatment of distributions, but only during the PTTP. After expiration of the PTTP, any distributions made by the former S corporation would be treated as coming first from the corporation's E&P and thus taxable as a dividend to the extent thereof.

iii. TCJA extends in part the generally beneficial treatment of distributions for certain former S corporations beyond the PTTP. Specifically, a distribution of money by an eligible terminated S corporation following the PTTP is treated as coming out of the corporation's AAA or E&P in the same ratio as the amount of the corporation's AAA bears to the amount of the corporation's accumulated E&P. Thus, even after expiration of the corporation's PTTP, some portion of any money distributed by the corporation may nevertheless be treated as a reduction in the shareholder's basis in its stock followed by a capital gain.

F. Tax-Exempt Organizations.

1. Tax-Exempt Organization Executive Compensation. For tax years beginning after December 31, 2017, a tax-exempt organization is subject to a tax

at the corporate tax rate (21% under the Act) on the sum of: (i) the remuneration (other than an excess parachute payment) in excess of $1 million paid to a covered employee by an applicable tax-exempt organization for a tax year; and (ii) any excess parachute payment (as newly defined) paid by the applicable tax-exempt organization to a covered employee. A covered employee is an employee (including any former employee) of an applicable tax-exempt organization if the employee is one of the five highest compensated employees of the organization for the tax year or was a covered employee of the organization (or a predecessor) for any preceding tax year beginning after December 31, 2016. Remuneration is treated as paid when there is no substantial risk of forfeiture of the rights to such remuneration.

2. Private Colleges and Universities. For tax years beginning after December 31, 2017, an excise tax equal to 1.4% is imposed on net investment income of certain private colleges and universities. The tax applies only to private colleges and universities with at least 500 students, more than 50% of the students of which are located in the U.S., and with assets (other than those used directly in carrying out the institution's exempt purpose) of at least $500,000 per student. The number of students is based on the daily average number of full-time equivalent students (full-time students and part-time students on an equivalent basis). Net investment income is gross investment income minus expenses to produce the investment (but disallowing the use of accelerated depreciation methods or percentage depletion).

3. Unrelated Business Taxable Income. For tax years beginning after December 31, 2017 (subject to an exception for net operating losses arising in a tax year beginning before January 1, 2018, that are carried forward), losses from one unrelated trade or business may not be used to offset income derived from another unrelated trade or business. Gains and losses have to be calculated and applied separately.

G. Electing Small Business Trusts.

1. Qualifying Beneficiaries. An electing small business trust (ESBT) may be a shareholder of an S corporation. Generally, the eligible beneficiaries of an ESBT include individuals, estates, and certain charitable organizations eligible to hold S corporation stock directly. Under pre-TCJA law, a nonresident alien individual may not be a shareholder of an S corporation and may not be a potential current beneficiary of an ESBT. Under TCJA, effective on January 1, 2018, a nonresident alien individual may be a potential current beneficiary of an ESBT.

2. Charitable Contribution Deduction. Under pre-TCJA law, the deduction for charitable contributions applicable to trusts, rather than the deduction applicable to individuals, applied to an ESBT. Generally, a trust is allowed a charitable contribution deduction for amounts of gross income, without limitation, which pursuant to the terms of the governing instrument are paid for a charitable purpose. No carryover of excess contributions is allowed. An individual is allowed a charitable contribution deduction limited to certain percentages of adjusted gross income, generally with a 5-year carryforward of amounts in excess of this limitation. Under TCJA, for tax years beginning after December 31, 2017, the charitable contribution deduction of an ESBT is not determined by the rules generally applicable to trusts, but rather by the rules

applicable to individuals. Thus, the percentage limitations and carryforward provisions applicable to individuals apply to charitable contributions made by the portion of an ESBT holding S corporation stock.

II. FEDERAL

A. Bipartisan Budget Act. The 640-page Bipartisan Budget Act of 2018, H.R.1892, contains many tax provisions, including a retroactive extension of a number of expiring tax provisions for 2017 only. The act also contains a number of disaster relief provisions, many of them for victims of the California wildfires, as well as special relief provisions for Puerto Rico.

1. Qualified Plans.

a. The act increases the limit on the amount of a loan from a qualified employer plan that will not be treated as a distribution, from $50,000 to $100,000. This increase applies to loans made on or after February 9, 2018, through December 31, 2018. The act also removes the Sec. 72(p)(2)(A)(ii) "one-half of the present value" limitation for these loans and allows for a longer repayment period.

b. The act also modifies the rules for hardship distributions, directing the IRS, not later than one year after February 9, 2018, to modify Regs. Sec. 1.401(k)–1(d)(3)(iv)(E) to eliminate the rule prohibiting contributions to qualified plans for six months after a taxpayer takes a hardship distribution. The new rule will be effective for plan years beginning after December 31, 2018.

2. Individual Tax Incentives. Provisions for individuals that expired at the end of 2016 that were retroactively reinstated, but only through 2017, include:

a. Sec. 108(a)(1)(E), which excludes from gross income discharge of qualified principal residence indebtedness income.

b. The Sec. 163(h)(3) treatment of mortgage insurance premiums as qualified residence interest, which permits a taxpayer whose income is below certain thresholds to deduct the cost of premiums on mortgage insurance purchased in connection with acquisition indebtedness on the taxpayer's principal residence.

c. Sec. 222, which provides an above-the-line deduction for qualified tuition and related expenses.

3. Business Tax Incentives. Provisions for businesses that expired at the end of 2016 but have been retroactively reinstated for one year, through 2017 (meaning the provisions are not in effect for 2018, except where otherwise indicated), include:

a. The Sec. 45A Indian employment tax credit for employers of enrolled members of Indian tribes (or their spouses) who work on and live on or near an Indian reservation.

b. The Sec. 45G railroad track maintenance credit, equal to 50% of the qualified railroad track maintenance expenditures paid or incurred by an eligible taxpayer.

c. The Sec. 45N mine rescue team training credit, which provides a credit for a portion of the training costs for qualified mine rescue team employees.

d. Sec. 168(e)(3)(A), which allows certain racehorses to be depreciated as three-year property instead of seven-year property.

e. Sec. 168(i)(15), which allows a seven-year recovery period for motorsports entertainment complexes.

f. Sec. 168(j), which allows owners accelerated depreciation for qualifying property used predominantly in the active conduct of a trade or business within an Indian reservation.

g. The Sec. 179E election to expense mine safety equipment, which permits taxpayers to elect to treat 50% of the cost of any qualified advanced mine safety equipment as a deduction in the year the property is placed in service.
•The Sec. 181 special expensing rules for certain film and television productions, which allows taxpayers to treat costs of any qualified film or television production as a deductible expense. The provision also applies to live theatrical productions.

h. Sec. 199(d)(8), which permits a deduction for income attributable to domestic production activities in Puerto Rico (Sec. 199 was repealed in P.L. 115-97, so this provision is of necessity only effective for one year).

i. Sec. 1391 empowerment zone tax incentives are extended through 2017.

j. The Sec. 7652(f) temporary increase in the limit on cover over of rum excise taxes from $10.50 to $13.25 per proof gallon to Puerto Rico and the Virgin Islands, which expired at the end of 2016, has been retroactively extended through 2021.

k. The American Samoa economic development credit.

l. Timber gains: C corporations' timber gains are subject to a 23.8% tax rate for 2017 as well as 2016, as under current law. (This provision is not needed after 2017 to offset the higher corporate tax rate since the top corporate tax rate was reduced to 21% by P.L. 115-97.)

4. Energy Tax Incentives. Provisions for energy expenses that expired at the end of 2016, but were retroactively extended for one year, through 2017 (unless indicated otherwise), include:

a. Sec. 25C, which provides a 10% credit for qualified nonbusiness energy property.

b. The Sec. 25D credit for residential energy property for qualified fuel cell property, small wind energy property, geothermal heat pump property, qualified solar electric property, and solar water heating property. This credit was extended through 2021.

c. Sec. 30B, which provides a credit for qualified fuel cell motor vehicles.

d. Sec. 30C, which provides a 30% credit for the cost of alternative (non-hydrogen) fuel vehicle refueling property.

e. The Sec. 30D 10% credit for plug-in electric motorcycles and two-wheeled vehicles.

f. Sec. 40(b)(6), which provides a credit for each gallon of qualified second-generation biofuel produced.

g. The Sec. 40A credit for biodiesel and renewable diesel, which includes the biodiesel mixture credit, the biodiesel credit, and the small agri-biodiesel producer credit.

h. The Sec. 45(e)(10)(A)(i) production credit for Indian coal facilities.

i. Sec. 45 credits for facilities producing energy from certain renewable resources.

j. Sec. 45L, which provides a credit for each qualified new energy-efficient home constructed by an eligible contractor and acquired by a person from the eligible contractor for use as a residence during the tax year.

k. The Sec. 48 credits for fiber optic solar lighting system, geothermal heat pump, small wind energy, and combined heat and power properties and the credit for qualified fuel cell and microturbine plant property. The credits are extended through 2021, subject to a phaseout.

l. Sec. 168(l), which provides a depreciation allowance equal to 50% of the adjusted basis of qualified second-generation biofuel plant property.

m. The Sec. 179D deduction for energy-efficient commercial buildings.

n. The Sec. 451(i) special rule for sales or dispositions to implement Federal Energy Regulatory Commission or state electric restructuring policy for qualified electric utilities.

o. The Sec. 6426(c) excise tax credits for alternative fuels and the Sec. 6427(e) outlay payments for alternative fuels.

5. Form 1040SR. Other notable provisions in the act include mandating the creation of a new Form 1040SR, a special tax form for taxpayers over 65 that is supposed to be as simple as Form 1040-EZ, Income Tax Return for Single and Joint Filers With No Dependents, but allow for reporting Social Security and retirement distributions.

6. Puerto Rico. The act also adds each low-income community in Puerto Rico to be designated as a qualified opportunity zone under Sec. 1400Z-1, which allows those areas to qualify for certain tax incentives. This provision is effective Dec. 22, 2017, the date of enactment of P.L. 115-97.

B. Partnership Audit Rules. The Bipartisan Budget Act of 2015 (the "BBA") made significant changes to the rules governing audits of entities treated as partnerships for U.S. federal income tax purposes. It is generally effective for tax years that start after December 31, 2017. The Treasury and the IRS have previously released three sets of proposed regulations relating to the BBA. On January 2, 2018, the IRS published final regulations on electing out of the new centralized partnership audit regime.

1. Background. Previously there are three different partnership audit regimes.

a. The "TEFRA" rules provided unified audit procedures that determined the tax treatment of all "partnership items" at the partnership level, after which the IRS could assess each audited-year partner individually based on such partner's share of any such adjustment. The TEFRA rules also included procedures for notice to and participation by partners.

b. A partnership with more than 100 partners could elect application of a simplified set of audit rules (the "electing large partnership" rules) under which partnership-level adjustments generally also flowed through to partners, but to those partners who are partners in the year the adjustment took effect (not, as under the TEFRA rules, in the earlier audited year).

c. For certain small partnerships not subject to the foregoing, adjustments to partnership items of income, gain, loss, deduction or credit were determined in separate proceedings for each partner under generally applicable audit procedures.

2. BBA Repeal and Replacement of TEFRA and Electing Large Partnership Rules. Effective for tax years beginning after December 31, 2017, the BBA repealed both the TEFRA and electing large partnership rules and replaced them with a

new partnership audit regime applicable to all partnerships. A narrowly defined category of small partnerships is eligible to elect out of the provisions for a given taxable year, with the result that any adjustments to such a partnership's items can be made only at the partner level. This election may be made only by partnerships with 100 or fewer partners, each of which is an individual, a C corporation, an S corporation or an estate of a deceased partner. Thus, for example, any partnership having another partnership as a partner is not eligible to elect out of the new audit regime.

3. Partnership-Level Audit Determinations under the BBA. Under the BBA, any adjustment to items of partnership income, gain, loss, deduction or credit, and any partner's distributive share thereof, are determined at the partnership level. Thus, the BBA in general does not make distinctions (of critical importance under the TEFRA rules) among partnership items, non-partnership items and items affected by partnership items.

4. Default Rule: Partnership-Level Tax at Maximum Statutory Rate. The new rules provide partnerships flexibility in determining how (and against whom) audit adjustment-related tax is calculated and ultimately assessed. Notably, specific factual circumstances such as the various partners' tax profiles or changes in partner interests between the audited year and a subsequent adjustment could significantly impact both the total amount of tax collected and the portion that various partners (whether current or former) bear. As a default, the "imputed underpayment" – the tax deficiency arising from a partnership-level adjustment with respect to an audited partnership tax year – is calculated using the maximum statutory income tax rate and is assessed against and collected from the partnership in the year that such audit (or any judicial review) is completed. In addition, the partnership is directly liable for any related penalties and interest, calculated as if the partnership had been originally liable for the tax in the audited year. These default rules are subject to two primary exceptions:

a. *Potential Reduction in Partnership Liability*. A partnership's imputed underpayment may be reduced to the extent partners voluntarily file amended tax returns and pay any tax due for the audited year, or if the partnership demonstrates that partnership items are allocable to partners either not subject to tax (in the case of a tax-exempt entity) or taxed at reduced corporate or capital gain rates. Treasury is delegated with implementing procedures to take into account these and other partner-specific reductions, but the scope of any additional reductions is unknown (including the extent to which a partner's non-U.S. status will be a permitted basis to apply reduced tax rates, and whether partners filing amended returns must pay any associated interest and penalties). Based on the legislation itself, most partner-specific characteristics (such as the existence of net operating losses) would not reduce the imputed underpayment. Nor does the legislation contemplate how the IRS would adjust partnership items otherwise determined solely with respect to individual partners (such as percentage depletion or partner-specific basis adjustments).

b. *Partnership Elects to Shift Liability to Partners*. Alternatively, partnership-level assessment may generally be avoided altogether if the partnership elects to issue adjusted information returns to each of the audited-year partners and the IRS, with such partners taking any adjustment into account on their individual returns in the year in which they receive the adjusted information return. Under this alternative, the

audited-year partners (rather than the partnership) are liable for any related penalties and interest, but with deficiency interest calculated at an increased rate and running from the audited year.

5. Procedural Changes. The BBA also effects significant changes to procedural aspects of partnership audits:

a. "*Partnership Representative" granted considerable power*. The "tax matters partner" role under prior law is replaced with an expanded "partnership representative" role. The partnership representative is not required to be a partner, has sole authority to act on behalf of the partnership in an audit proceeding, and binds both the partnership and the partners with its actions in the audit.

b. *Partner rights significantly curtailed*. The IRS is no longer required to notify partners of partnership audit proceedings or adjustments, and partners are bound by determinations made at the partnership level. Partners no longer have rights to participate in partnership audits or related judicial proceedings, nor standing to bring a judicial action if the partnership representative does not challenge an assessment.

c. *Partnership deposit required*. Partnerships challenging an assessment in a District Court or the Court of Federal Claims are required to deposit the entire amount of the partnership's imputed liability (in contrast to existing rules that only require a deposit of the petitioning partner's liability).

d. *Single statute of limitations*. The statute of limitations for adjustments will be calculated solely with reference to the date the partnership filed its return.

6. Regulations.

a. On June 13, 2017, Treasury and the IRS released proposed regulations which provide guidance on the applicable procedures, the determination of the amount of taxes, interest and penalties owed, and other consequences of an adjustment to a partnership tax return. Among other provisions, these proposed regulations include procedures for electing out of the new regime, designating a partnership representative, filing administrative adjustment requests, and determining amounts owed by a partnership or its partners from adjustments following partnership exam.

i. Consistent with the statute, partnerships are eligible to opt out of the regime if: (i) they have 100 or fewer partners during the year; and (ii) all partners are "eligible partners" at all times during the tax year.

ii. Under the proposed regulations, a partnership has 100 or fewer partners during the year if it is required to furnish 100 or fewer statements under Section 6031(b) during the tax year for which the partnership makes the election. A special rule applies for partnerships with S corporation partners: any statements

required to be filed by the S corporation partner for the relevant tax year under Section 6037(b) are added to the number required to be filed by the partnership, for purposes of determining whether more than 100 statements are required to be furnished.

iii. Regarding tiered partnership structures, the regulations did not expand the definition of "eligible partner" to include a disregarded entity. Instead, the proposed regulations define "eligible partner" as any person who is an individual, C corporation, "eligible foreign entity," S corporation (even if one of its shareholders is not) or an estate of a deceased partner. The term "eligible partner" does not include partnerships, trusts, foreign entities that are not eligible foreign entities, disregarded entities, nominees, other similar persons that hold an interest on behalf of another person, and estates that are not estates of a deceased partner.

iv. Under the proposed regulations, a partner's treatment of each item of income, gain, loss, deduction or credit attributable to a partnership must be consistent with the treatment of those items on the partnership return (including with respect to the amount, timing and characterization). In addition, the proposed regulations state that consistency is determined based on the partnership return filed with the IRS, not by reference to the schedules provided to the partner.

v. In any partnership proceeding, the partnership representative is the sole person with authority to act on behalf of the partnership and the partners. The proposed regulations would require a partnership to designate an eligible partnership representative. The partnership representative may be any person, as defined in Section 7701(a)(1), including an entity, and need not be a partner. If an entity is designated, however, the partnership must also appoint and identify an individual to act on the entity's behalf.

vi. The partnership must designate a representative on the partnership's return for each tax year — designations for one year do not carry over to other years. Generally, once made, a designation may not be changed until after the partnership receives a notice of audit.

vii. Under the new audit regime, partnerships are generally responsible for paying any imputed underpayment that results from an IRS examination, but one or more partners in the year under examination (the reviewed year) may instead pay their share of the taxes owed either through a "modification process" or through a "push-out election." Although the IRS may consider alternative forms of modification, the proposed regulations specifically describe seven types of modifications that the IRS will consider if requested by the partnership, including those relating to: (i) amended returns, (ii) tax-exempt partners, (iii) rate modification, (iv) certain passive losses of publicly traded partnerships, (v) number and composition of imputed underpayments, (vi) partnerships with partners that are Section 860 "qualified investment entities," and (vii) partner closing agreements.

viii. The proposed regulations would allow for multiple imputed underpayments resulting from an IRS audit. Each administrative proceeding that ends with the determination by the IRS of an imputed underpayment would result in a general imputed underpayment. The IRS has the discretion to determine a specific

imputed underpayment on the basis of certain adjustments allocated to one partner or a group of partners based on the items or adjustments having the same or similar characteristics, based on the group of partners sharing similar characteristics, or based on the partners having participated in the same or similar transactions. As a result, there may be multiple specific imputed underpayments depending on the adjustments. The partnership has the option to pay none, some or all of the imputed underpayments and file an election to "push-out" those adjustments resulting in imputed underpayments which the partnership chooses not to pay.

ix. Under the proposed regulations, a partnership may elect under Section 6226 to "push out" adjustments to its reviewed year partners rather than paying the imputed underpayment. To be valid, this election must comply with all the regulatory requirements for such an election and the partnership must provide notice to the partners and IRS. The proposed regulations make it clear that the partnership is no longer liable for any imputed underpayment once a valid "push out" election is made. Elections once made may only be revoked by the IRS.

x. The proposed regulations stipulate that a partnership may only make an election under Section 6226 within 45 days of the date the final partnership adjustment (FPA) was mailed by the IRS. The regulations specify what information must be included when making the election. They also state that electing partnerships must furnish statements to the reviewed year partners with respect to the partner's share of the adjustments and also file those statements with the IRS in the time, form and manner prescribed. The proposed regulations contain a requirement that the statement issued by the partnership contain a "safe harbor" amount calculated by the partnership that a partner can elect to pay rather than have the partner compute any additional tax the partner may owe based upon the actual effect the adjustment will have on the partner's reviewed year and any intervening years. The regulations include requirements with respect to the contents of these statements and the reporting of the partner's share of adjustments and other amounts.

b. On November 30, 2017, the IRS issued proposed regulations providing guidance on the application of certain international tax rules under the BBA.

c. On December 19, 2017, the IRS published a third set of proposed regulations. Those proposed regulations address Section 6226 push-out elections in tiered partnership structures. Those proposed regulations also address other procedural issues, including tax assessment and collection, penalties and interest, periods of limitations, and judicial review of partnership adjustments.

d. On January 2, 2018, the IRS released final regulations (TD 9829) on electing out of the centralized partnership audit regime. These final regulations generally adopt the rules that were proposed in the June 13, 2017, proposed regulations, with some minor revisions and clarifications.

e. The IRS has also issued final regulations (T.D. 9839) on the designation and authority of the partnership representative under the centralized partnership audit regime, and on the election to apply the regime to partnership tax years beginning after November 2, 2015, and before January 1, 2018.

i. The final regulations clarify that a disregarded entity can serve as the partnership representative, and the partnership can also list itself as the representative — and that doesn't mean the named individual has to be an employee of the named partnership. However, a designated individual must still be named on the return.

ii. Since the representative has so much power, practitioners commenting on the proposed regulations expressed concern that the representative named on a return could not be removed until the partnership received a notice of administrative proceeding (NAP) or an administrative adjustment request (AAR) is filed. In the final rules, the IRS and Treasury uphold the rule in the proposed regulations, but say that as the agency gains experience working with the new regime, it may revisit the issue.

iii. Once a partnership representative or designated individual resigns, that representative cannot designate a successor — a change from the proposed rules. The IRS and Treasury considered the comments and say a resigning representative can have interests adverse to the partnership, so naming its successor would be unfair. What's more, the final regulations no longer allow a representative to resign at the time an AAR is filed — now a representative can resign only after a NAP has been issued by the IRS, or until further guidance is issued.

iv. Under the proposed rules, only a general partner at the close of the tax year for which the partnership representative designation is in effect could sign the revocation — for LLCs, only member-managers could sign the revocation. In response to comments, the final regulations scrap that rule and say that any partner can sign to revoke the representative, and they relax the requirement that the signing partner be a partner at the end of the tax year.

v. One of the most talked-about aspects of the new audit regime has been the broad power given to the partnership representative. The named representative can be an entity with a substantial presence in the United States, but an individual must be designated to act on the entity's behalf. Under the old rules, once a partnership representative was named on a return, it would take 30 days after the IRS was notified of a revocation to be effective, which could be problematic if that representative had adverse interests to the partnership and could still bind it. In response, the IRS and Treasury in the final regulations generally make the resignation or revocation of a representative effective immediately upon receipt by the IRS.

C. New Procedures When Calling Practitioner Priority Service (PPS) and Changes To Third Party Authorization Forms.

1. To better protect sensitive taxpayer data, the IRS announced that it will request additional information from tax professionals who contact the IRS through the Practitioner Priority Service or any toll-free IRS telephone number.

2. This procedural change will require tax practitioners to provide personal information so that IRS customer service representatives may confirm their

identities. This additional information may include data such as the tax practitioner's Social Security number and date of birth.

3. The IRS also made an update to Form 2848, Power of Attorney, and Form 8821, Tax Information Authorization, that will require tax practitioners to inform their clients if they are using an Intermediate Service Provider to access client transcripts via the Transcript Delivery System. A box must be checked if the tax practitioner is using a third party. IRS defines Intermediate Service Providers as privately owned companies that offer subscriptions to their software and/or services that the taxpayer's authorized representative can use to retrieve, store, and display tax return data (personal or business) instead of obtaining tax information directly from the IRS.

D. Back-to-Back Loan Regs Do Not Alter Bona Fide Indebtedness Test. In *Homero F. Meruelo v. Commissioner*, No. 1795-13; T.C. Memo. 2018-16, the Tax Court sustained the Service's partial disallowance of a flow-through net operating loss deduction that an individual taxpayer claimed stemming from his ownership interest in an S corporation, because the taxpayer did not have sufficient basis in the S corporation. His basis was under $5 million and the NOL he claimed exceeded $13 million. The taxpayer had argued that he had basis through back-to-back loans among various Subchapter S corporations, partnerships and LLCs comprising his real estate business, some of which were owned with others. According to the court, "Here, petitioner seeks to treat as his incorporated pocketbook 11 distinct [Sub S] affiliates. Many of these companies had co-owners besides petitioner. And because the inter-company payments allegedly creating his basis involved netting hundreds of accounts payable against hundreds of accounts receivable, petitioner is necessarily contending that his 'incorporated pocketbook' not only disbursed funds but regularly received them. We have never found an incorporated pocketbook on such facts." 2018 T. C. Memo. 16, at pp. 18-19.

E. IRS Modifies Certain 2018 Benefit Limits. The IRS announced in Revenue Procedure 2018-18 revised 2018 inflation-adjusted benefit amounts as the Tax Cuts and Jobs Act of 2017 ("Act") modified the index on which these benefit amounts are annually updated. The Act now requires the use of the chained CPI-U index for these parameters. These changes are retroactive to January 1, 2018.

1. Health Savings Accounts (IRC §223). The annual contribution limit for coverage other than self-only coverage has been lowered to $6,850 (originally $6,900). All other HSA-related limits remain the same and are as follows:

2018

Annual Contribution Limit	
Self-Only Coverage	$3,450
Family Coverage	**$6,850**
Annual Deductible for Qualified High Deductible Health Plan	
Self-Only Coverage	$1,350
Family Coverage	$2,700
Maximum Annual Out-of-Pocket Limit	
Self-Only Coverage	$6,650
Family Coverage	$13,300

The IRS subsequently announced (IR-2018-107) relief for taxpayers with family coverage under a high deductible health plan (HDHP) who contribute to a health savings account, allowing them to treat $6,900 as the maximum deductible HSA contribution for 2018.

2. Adoption Assistance Programs (IRC §137). The 2018 amount that can be excluded from an employee's gross income for the adoption of a child with special needs has been lowered to $13,810 (originally $13,840) which is the same amount that can be excluded from an employee's gross income for the amounts paid or expenses incurred by an employer for qualified adoption expenses furnished pursuant to an adoption assistance program for other adoptions by the employee. The amount excludable from an employee's gross income begins to phase out under IRC §137(b)(2)(A) for taxpayers with 2018 modified adjusted gross income in excess of $207,140 (originally $207,580).

3. Failure to File Correct Information Returns (IRC §6721) and Failure to Furnish Correct Payee Statements (IRC §6722). The general penalty amount for 2018 (forms and returns filed/issued in 2019) will remain at $270 per return although the maximum penalty will be lowered to $3,275,500 (originally $3,282,500). These penalties apply to Forms 1094/1095 (B and C Series) filed in 2019.

F. IRS Ending Offshore Voluntary Disclosure Program. The IRS has announced (IR-2018-52) that it will begin to ramp down and end the 2014 Offshore Voluntary Disclosure Program on September 28, 2018. The OVDP allowed taxpayers to avoid prosecution by voluntarily disclosing untaxed money held overseas and paying a set penalty. The OVDP, which has been available since 2009, has experienced a significant decline in taxpayer participation as awareness of offshore tax and reporting requirements has increased.

G. IRS Scraps Leveraged Partnership Rules, Keeps Bottom-Dollar Ban. On June 18, 2018, the IRS issued proposed regulation (REG-131186-17) that eliminates the previously issued proposed and temporary regulations (T.D. 9788) on the treatment of liabilities for disguised sale purposes under Section 707. However, bottom-dollar guarantees — situations in which a partner guarantees a certain amount of outstanding debt to increase his or her basis in the partnership interest — are not included in the change. Under the now-displaced temporary regulations, the IRS essentially treated all liabilities as nonrecourse liabilities for disguised sale purposes, a

shift so dramatic that some practitioners questioned the agency's authority to do so. These proposed and temporary regulations were targeted for elimination shortly after President Trump issued Executive Order 13789 in April 2017, calling for the review and possible removal of all significant tax regulations issued after January 1, 2016. The disguised sale rules were among eight regulations the IRS highlighted for possible removal in a report issued three months later (Notice 2017-38, 2017-30 IRB 147). The IRS followed through on that removal by saying in the June 18, 2018, proposed regulation that it will go back to the old approach of applying separate rules for a partnership's recourse and nonrecourse liabilities. That approach treats a partner's share of recourse liabilities in Treas. Reg. Section 1.707-5(a)(2)(i) as the same share of recourse liabilities under Section 752. It then treats a partner's share of nonrecourse liabilities in Treas. Reg. Section 1.707-5(a)(2)(ii) by applying the same percentage the partner used to determine the partner's share of excess nonrecourse liabilities under Treas. Reg. Section 1.752-3(a)(3), which looks only to a partner's profit interest in allocating the liability.

H. Supreme Court Abandons Physical Presence Standard.

1. On June 21, 2018, the U.S. Supreme Court issued a decision in *South Dakota v. Wayfair, Inc.,* U.S. S.Ct., Dkt. No. 17-494, 06/21/2018, overturning the physical presence standard espoused in *Quill Corp. v. North Dakota By and Through Heitkamp*, (1992, U.S.) 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 and *National Bellas Hess, Inc. v. Department of Revenue of State of Ill.,* (1967, U.S.) 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505. The Court ruled that the correct standard in determining the constitutionality of a state tax law is whether the tax applies to an activity that has "substantial nexus" with the taxing state. The case involves South Dakota's economic nexus law, which imposes tax collection and remittance duties on out-of-state sellers meeting gross sales and transaction volume thresholds. In overturning its prior precedents the Court determined that physical presence is not required to meet the "substantial nexus" requirement laid out in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). The Court held that the respondents had established substantial nexus in this case through "extensive virtual presence." While Wayfair clearly overturns the physical presence requirement, it does not provide states carte blanche to enact or enforce all forms of economic nexus laws. South Dakota's law has several features that prevented it from running afoul of Commerce Clause protections: (i) the law has a safe harbor provision for transacting limited business in the state that does not meet the specific thresholds, (ii) the law is not retroactive, and (iii) South Dakota is a member of the Streamlined Sales and Use Tax Agreement, which reduces administrative and compliance costs for taxpayers and even provides state-funded sales tax administration software. Other states with economic nexus provisions will need to apply the same test in determining whether those provisions pass constitutional muster. Given the Court's conclusion that "physical presence is not necessary to create substantial nexus," this decision will impact other state taxes, such as corporate income taxes, which could apply to the income of an entity conducting significant business activities in a state without having a physical presence there. Economic nexus laws in the sales and use tax environment are an import from the corporate income tax realm. Most state and federal courts have taken the position that the physical presence standard does not apply in the corporate income tax environment, and many states

have been emboldened to enact "factor presence" laws tied to sales, property or payroll in the state.

2. As a result of the decision in Wayfair, Michigan changed its administrative requirement, stated in Michigan Revenue Administrative Bulletin No. 2018-16, 08/01/2018, to require all applicable mail order and online retailers physically located outside of Michigan to pay state sales tax and file tax returns for taxable sales made after September 30, 2018. This change allows for the more efficient collection of the sales tax by collecting from businesses rather than individuals. Under the change, out-of-state (remote) sellers with sales exceeding $100,000 or 200 or more transactions in Michigan in the previous calendar year will be required to collect and remit sales tax. These thresholds are consistent with South Dakota’s thresholds that were upheld by the U.S. Supreme Court. All applicable mail order and online retailers physically located outside of Michigan must pay state sales tax and file tax returns for taxable sales made after September 30, 2018. The first payments will be due on November 20, 2018.

I. New Form 1040 for 2019 Tax Filing Season. The IRS announced (IR-2018-146) that it plans to streamline Form 1040, "U.S. Individual Income Tax Return," into a shorter and simpler form for the 2019 tax filing season. The new Form 1040 is about half the size of the current version of the form that it would replace along with Form 1040A and Form 1040EZ, allowing 150 million taxpayers to use the same form. The IRS has released a draft version of the new form. The new Form 1040 uses a “building block” approach, in which the tax return is reduced to a simple form. That form can be supplemented with additional schedules if needed. Taxpayers with straightforward tax situations would only need to file this new 1040 with no additional schedules.

J. Due Diligence Penalty. The IRS has issued proposed regulations (REG-103474-18), following the 2016 expansion of the return preparer due diligence penalty under section 6695(g), so it would apply not only to eligibility determinations for the child tax credit and others but also to determinations of whether a taxpayer is eligible for head of household filing status.

K. Disclosure Requirements for Exempt Organizations. The IRS has indicated in Rev. Proc. 2018-38 that exempt organizations, other than Section 501(c)(3) organizations, are no longer required to report the names and addresses of their contributors on Schedule B of their forms 990 or 990-EZ but still must have the information on hand if the IRS asks for it. The revised reporting requirements will apply to information returns for tax years ending on or after December 31, 2018, and generally will apply to returns due on or after May 15, 2019.

L. Final Regulations Implement Changes Accelerating Form W-2 Series. The IRS has issued final regulations (T.D. 9838) implementing changes to accelerate the filing of the Form W-2 series (except Form W-2G) and forms that report nonemployee compensation to make them available earlier in the filing season for use in the IRS’s identity theft and refund fraud detection processes. Effective August 3, 2018, the final regulations adopt proposed regulations (REG-132075-14) issued in August 2015, but only remove the automatic 30-day extension to file the Forms W-2

series (except Form W-2G) and forms reporting nonemployee compensation (currently Form 1099-MISC with information in box 7).

M. SALT Workaround. Proposed regulations issued August 23, 2018 (REG-112176-18), would require a taxpayer making payments to an entity eligible to receive tax-deductible contributions to reduce their charitable deduction by the amount of any state or local tax credit received for the donation. Exceptions are provided for dollar-for-dollar state tax deductions and for tax credits of no more than 15 percent of the payment amount or of the fair market value of the property transferred.

III. MICHIGAN

A. Michigan Response to TCJA

1. Exemptions.

a. Currently under the Michigan Income Tax Act, a taxpayer can claim a personal exemption and multiply the amount by the number of personal or dependency exemptions "allowable on the taxpayer's federal income tax return pursuant to the internal revenue code." L. 2018, S748 a/k/a "PA 38" removes the reference to the federal income tax return and provides for the determination of exemptions as follows:

i. Each taxpayer may claim 1 personal exemption. If a joint return is not made by the taxpayer and his or her spouse, the taxpayer may claim a personal exemption for the spouse if the spouse does not have any gross income and is not the dependent of another taxpayer.

ii. A taxpayer may claim a dependency exemption for each individual who is a dependent of the taxpayer for the tax year.

b. With regard to the $1,500 deduction available to an individual to whom a deduction is allowable to another taxpayer, the changes remove federal references and replace them with the exemption system described above.

c. Currently under the Act, the personal exemption amount is set at either an inflation-adjusted amount (rounded to the nearest $100) or an amount specifically set in statute, whichever is greater. The personal exemption amount for tax year 2017 is $4,000.

d. As changed, the personal exemption amounts are as follows:

On and after January 1, 2014 and before January 1, 2018: $4,000
For the 2018 tax year: $4,050
For the 2019 tax year: $4,400
For the 2020 tax year: $4,750
For the 2021 tax year: $4,900

For the 2022 tax year and each tax year thereafter, the inflation-adjusted amount would be increased by an additional $600.

e. Section 30e of the Act is repealed. This section defines “dependent” as an individual for whom the taxpayer may claim a dependency exemption on the taxpayer’s federal income tax return pursuant to the Internal Revenue Code. The bill would add “dependent” to the definitions section of the Act and define it as “a dependent as defined in Section 152 of the Internal Revenue Code.”

f. The definition of “Internal Revenue Code” is changed to the United States Internal Revenue Code of 1986 in effect on January 1, 2018.

g. Section 30f of the Income Tax Act is repealed. This section provides for adjustments from taxable income for interest earned on the contributions to a taxpayer’s education savings account and distributions that are qualified withdrawals from an education savings account, to the extent not deducted in determining adjusted gross income. Instead, the bill would allow a taxpayer to deduct, to the extent included in adjusted gross income, interest earned and qualified withdrawals.

h. An identical change is made regarding interest and distributions for an ABLE savings account, allowing interest earned and qualified withdrawals to be deducted to the extent included in adjusted gross income.

2. Repatriation of Deferred Foreign Income; Global Intangible Low-Taxed Income. The Michigan Department of Treasury has announced in Michigan Department of Treasury Update, 05/01/2018, that it has been evaluating the impact to the state's corporate income tax from the federal Tax Cuts and Jobs Act (TCJA), and made some preliminary determinations, especially with regards to the deemed repatriation of accumulated deferred foreign sourced earnings of a U.S. shareholder and the inclusion in income of U.S. shareholders of "global intangible low-taxed income" earned by certain of its Controlled Foreign Corporation (CFC) subsidiaries.

a. The TCJA amended IRC § 965 which mandates a deemed repatriation of deferred foreign income of a specified foreign corporation (as defined in the IRC). The TCJA requires that accumulated deferred post-1986 foreign-sourced earnings and profits (E&P) of a U.S. shareholder owning at least 10% of a specified foreign corporation be recognized (via a deemed repatriation dividend) and added to the U.S. shareholder's pro rata share of its foreign subsidiary's Subpart F income. According to the Michigan Department of Treasury, this additional income, characterized as a deemed dividend to the U.S. shareholder, is part of the shareholder's federal taxable income-notwithstanding that the IRS in its March 2018 guidance has directed that this income be separately identified and the taxes separately paid. If this additional deemed distributed income is included as the U.S. shareholder's pro rata share of Subpart F income, then the taxpayer would deduct it to determine its CIT tax base. Mich. Comp. Laws Ann. § 206.623(2)(d) of the CIT provides that to the extent included in federal taxable income, dividends from foreign persons and foreign operating entities be deducted in calculating CIT tax base, including amounts determined under Subpart F (IRC § 951 to IRC § 964 , and by extension, IRC § 965).

b. The TCJA also added IRC § 951A, which requires a U.S. shareholder of a CFC to include its pro rata share of the CFC's "global intangible low-taxed income" (GILTI) into gross income each year, starting in taxable years beginning after December 31, 2017. The Department preliminarily concludes that this income also would be excluded from a taxpayer's CIT tax base. While not considered to be Subpart F income, the TCJA explicitly states that GILTI is treated in the same manner as Subpart F income. Consequently, Mich. Comp. Laws Ann. § 206.623(2)(d) of the CIT would also result in this GILTI being deducted from the tax base to the extent included in federal taxable income. The Department would view the amount of GILTI included in federal taxable income to be net of the 50% GILTI deduction and the 37.5% FDII deduction provided under the IRC.

B. New Alternative Dispute Resolution Process. The Michigan Department of Treasury has issued a release explaining the new alternative dispute resolution process recently authorized by the legislature. Notice to Taxpayers Regarding Alternative Dispute Resolution, Mich. Dept. Treas., 12/27/2017.

1. Background. On December 20, 2017, L. 2017, H4976, P.A. 215 ("PA 215") was signed into law by Governor Snyder. PA 215 amends Mich. Comp. Laws Ann. § 205.21 and Mich. Comp. Laws Ann. § 205.28 to provide for a new, non-judicial dispute resolution process. Prior to the passage of PA 215, the Department was able to resolve disputes with taxpayers through negotiated settlement only within the confines of the judicial process-that is, after a contested matter had been timely appealed to the Michigan Tax Tribunal or to the Michigan Court of Claims.

2. New Dispute Resolution Process. Under the provisions of PA 215, the Department has the authority to settle tax disputes with taxpayers by accepting less than the full amount of tax in dispute, or increasing the amount of a taxpayer's refund, prior to the commencement of litigation. The new process is available to all taxpayers who have made a timely request for informal conference pursuant to Mich. Comp. Laws Ann. § 205.21(2)(c), except that a taxpayer may not request settlement consideration of its dispute more than 21 days after the date that the informal conference was held. After that point, a taxpayer may not request settlement as part of the informal conference process, and may only pursue settlement through litigation.

3. Settlement Standard. The Department may consider settling a tax dispute with a taxpayer if, after taking into consideration the factual and legal issues involved and the risks of litigating the dispute, it is in the State's best interests to accept a lesser amount of tax than the Department previously determined was owed by the taxpayer. Doubt as to the taxpayer's ability to pay or the Department's ability to collect the determined tax does not constitute a basis for settlement.

4. Settlement Proposals by Taxpayer. The process outlined in PA 215 requires that any settlement offer submitted by a taxpayer be in writing, signed by the taxpayer, and identify (i) the issues in dispute to be settled, (ii) the amount of the settlement offer, and (iii) the factual and legal bases supporting the taxpayer's settlement offer. The taxpayer must also include any supporting documentation. The State Treasurer's designee will determine whether to accept, reject, or counter the

settlement offer, and the taxpayer will be notified of the Department's decision in writing. If the settlement offer is not accepted, the Department will include in the written notification the factual and legal bases for the Department's rejection or counter-offer. A counter-offer made by the Department may be accepted, rejected, or further countered by the taxpayer.

5. Settlement Proposal by the Department. If the State Treasurer's designee determines to pursue settlement, the Department will notify the taxpayer in writing of the Department's settlement offer.

6. Unresolved Issues. If a settlement offer does not ultimately result in a settlement, or if only some of the pending issues are settled, the informal conference process will proceed as provided in Mich. Comp. Laws Ann. § 205.21(2), unless the taxpayer files a written notice of withdrawal. If the Department accepts the taxpayer's settlement offer or counter-offer, or the taxpayer accepts the Department's settlement offer or counter-offer, the Department and the taxpayer will execute a written agreement outlining the terms of the settlement. Where appropriate, the Department will then issue a final assessment to the taxpayer that reflects the agreement and the agreed-upon amount of liability as to the settled issues. A final assessment issued pursuant to a settlement agreement under PA 215 is not subject to challenge or appeal under the Revenue Act, nor is it reviewable in any court by mandamus, appeal, or other method of direct or collateral attack. The informal conference process will proceed as provided in Mich. Comp. Laws Ann. § 205.21(2) with respect to any disputed issues that are not included in the settlement agreement, unless the taxpayer files a written notice of withdrawal.

7. Effect of Offers on Subsequent Proceedings. Settlement offers, counter-offers, responses, settlement agreements, and the disposition of any settlement offer or counter-offer may not be offered by any party in litigation as proof of the validity of the Department's position or of the proper amount of the taxpayer's tax liability. All such documents are also exempt from disclosure under the Freedom of Information Act and may not be obtained through discovery in any proceeding.

8. Questions. Questions about the new alternative dispute resolution process may be directed to the Department's Alternative Dispute Resolution Office at (517) 373-3223.

C. Guidance on Principal Residence Exemption Changes. The Michigan State Tax Commission has issued guidance on L. 2017, H4905, which removed a requirement that a property must be unoccupied in order for an individual who resides in a nursing home or assisted living facility to continue to claim a principal residence exemption (PRE) on the property. As of May 2, 2018, an owner who previously occupied a property as his or her principal residence but presently resides in a nursing home, an assisted living facility, or another location solely for purposes of convalescence, may retain the exemption if he or she manifests an intent to return to the property by satisfying all of the following conditions: (i) the owner continues to own the property while residing in the nursing home, assisted living facility, or other location; (ii) the owner has not established a new principal residence; (iii) the owner maintains or provides for the maintenance of the property while residing in the nursing home,

assisted living facility, or other location for the purposes of convalescence; and (iv) the property is not leased and is not used for any business or commercial purpose. The State Tax Commission is instructing assessors that the burden of proof is on the taxpayer to prove the eligibility requirements to retain the PRE in these circumstances. Assessors should deny the PRE if the owner does not provide evidence that he or she is recovering from a serious illness or surgery. The assessor should deny the PRE if a non-owner occupant is residing at the property and paying for the utilities, maintenance of the property, or any other consideration to reside at the property while the owner is absent, since these are forms of rent. (State Tax Commission Memorandum: Changes in the Principal Residence Exemption Statute, 06/05/2018.)

D. Person with Right to Remain in Marital Home was an Owner for Purposes of Principal Residence Exemption. A taxpayer who, as a result of an irrevocable trust granting her the ability to remain in the marital home rent-free in order to maintain the standard of living she enjoyed prior to her husband's death, is an "owner" of the property for purposes of Mich. Comp. Laws Ann. § 211.7dd(a) , the personal residence exemption (PRE). *Breakey v. Dept. of Treasury*, Mich. Ct. App., Dkt. No. 339345, 06/07/2018.

E. Exemption from State Real Estate Transfer Tax for Certain Property Sold at a Loss Amended. L. 2018, H4643, effective 06/11/2018, amends the State Real Estate Transfer Tax Act to modify the criteria that a written instrument conveying an interest in property must meet to be exempt from the tax levied under the Act, for property eligible for the principal residence exemption that has not increased in value since its purchase. Under the bill, a written instrument conveying an interest in property for which an exemption is claimed under the principal residence exemption of the General Property Tax Act is exempt from the tax is if both of the following are met: (i) the transaction was for a price at which a willing buyer and seller would arrive through an arm's-length negotiation; and (ii) the state equalized valuation (SEV) of that property was equal to or less than the SEV determined as of the first tax day after the issuance of a certificate of occupancy for the residence, or the date of acquisition of the property, whichever comes later, by the seller or transferor for the same interest in property (previously, the SEV of that property was equal to or less than the SEV on the date of purchase or on the date of acquisition by the seller or transferor for the same interest in property).

F. Michigan Revises Unitary Business Group Control Test and Relationship Tests for Corporate Income Tax. The Michigan Department of Treasury has issued Michigan Revenue Administrative Bulletin No. 2018-12, 05/23/2018, updating the control test and the two alternative relationship tests that determine whether two or more entities are a unitary business group under the corporate income tax. The release replaces Michigan Revenue Administrative Bulletin No. 2013-1, 01/07/2013.

1. Unitary business group. Under the Corporate Income Tax ("CIT"), a unitary business group ("UBG") is two or more qualifying U.S. persons that satisfy both a control test and one of two alternate relationship tests, or an affiliated group that has properly elected to be treated as a UBG. A UBG is a single taxpayer under the CIT

and must file a combined return. Foreign persons and foreign operating entities cannot be included in a UBG.

2. Control Test. The control test is satisfied when one person owns or controls, directly or indirectly, more than 50% of the ownership interests with voting or comparable rights of the other person or persons.

3. Two Alternative Relationship Tests. The definition of a UBG, in addition to satisfying the control test, requires that the group of persons have business activities or operations that: (i) result in a flow of value between or among persons in the group; or (ii) are integrated with, are dependent upon, or contribute to each other. A taxpayer need only meet one of the two alternative tests to satisfy the relationship test. Affiliated groups making an election to be treated as a UBG under Mich. Comp. Laws Ann. § 206.691(2) need not satisfy a relationship test.

G. Refund of Tax Paid on Unclaimed Sales/Use Tax Exemption. L. 2018, H5620, effective 01/01/2019, allows a purchaser to apply for a sales tax refund from the Michigan Department of Treasury when the purchaser fails to claim a tax exemption at the time of purchase. The purchaser can submit a claim for a refund to the Department for the tax related to that purchase if all of the following conditions were met: (i) the claim for a refund was made within four years of the date of purchase; (ii) the purchaser submits to the Department an accurate record of the purchase that included the date of the purchase and the amount of sales tax paid to the seller for which the purchaser was seeking a refund; (iii) the purchaser submits to the Department a proper exemption claim; and (iv) the purchaser submits to the Department any additional information that it requires related to the purchaser's refund claim. The purchaser must also submit to the Department a form signed by the seller that contains information the Department requires to substantiate the refund claim. The form must contain a statement that the seller reported and paid the tax on the sale for which the purchaser is seeking a refund and that the seller has not claimed, and will not claim, a refund of that tax. L. 2018, H5621, effective 01/01/2019, provides similar procedures to apply for a use tax exemption.

H. Taxpayer Lacked Sufficient Nexus to be Subject to Detroit, Michigan Income Tax. A taxpayer lacked sufficient nexus to be subject to the Detroit, Michigan local income tax because it was not "doing business in the city" under Mich. Comp. Laws Ann. § 141.614 . A Detroit-based private equity firm had solicited investors to acquire partnership interests in a limited partnership (the "Fund"), which in turn was to acquire shares in existing "lower middle-market" companies. The private equity firm recommended that the Fund acquire shares in a Canadian company, for eventual sale, and as part of the transaction, the taxpayer was incorporated as a Delaware corporation for the sole purpose of holding the shares of the Canadian company to be acquired by the Fund. The taxpayer never possessed or acquired any other assets. Although the taxpayer possessed a Detroit mailing address, it did not have any employees, owned no real or personal property, provided no services, and sold no goods, either in Detroit or elsewhere. Various members and employees of the private equity firm were appointed to the taxpayer's board of directors. The taxpayer never held a board meeting. The Tax Tribunal rejected the city's argument that the taxpayer's "commercial domicile" was relevant to whether the taxpayer was doing business in the city, and instead employed

the constitutional analysis discussed in *Quill Corp. v. North Dakota*, U.S. S.Ct., 504 US 298, 112 S Ct 1904 (1992). The Tax Tribunal ultimately concluding that the record did not demonstrate that the taxpayer had either a physical presence in or substantial connection with Detroit. The Michigan Court of Appeals held this approach was not based on an error of law. In order to satisfy the statutory requirement of doing business "in the city," the taxpayer would have had to at least meet the minimum constitutional standards under the Due Process Clause and Commerce Clause. The court noted that various officers and directors of the taxpayer attested that they were employed by the private equity firm and worked for the benefit of the private equity firm. Essentially, these officers and directors worked to increase the value of the Canadian company and negotiate the sale of the Canadian company's shares for the benefit of the private equity firm. These activities were not conducted "on behalf" of the taxpayer any more than a business transaction is conducted "on behalf" of the bank account into which the proceeds will be deposited. The court also said that to the extent the taxpayer employed professional consultants, this fell under the exclusion found in Mich. Comp. Laws Ann. § 206.621(2)(b) . In addition, it was uncontested that the taxpayer was not engaged in the sale of any goods or services in Detroit (or indeed, anywhere). The court found that the lack of physical presence, under Quill, renders Detroit's assessment of income tax against the taxpayer violative of the Commerce Clause. Therefore, Detroit cannot satisfy the Mich. Comp. Laws Ann. § 141.614 requirement that the entity being assessed tax be doing business "in the city." *Apex Laboratories International Inc. v. City of Detroit*, Mich. Ct. App., Dkt. No. 338218, 05/17/2018 (unpublished).

I. Updated Taxpayer Bill of Rights Administrative Rules. The Michigan Department of Treasury has issued a Notice Regarding Amendments to the Taxpayer Bill of Rights Rules, Mich. Dept. Treas., 06/08/2018, explaining amendments to the Taxpayer Bill of Rights (TBOR) Rules that became effective May 4, 2018. The amendments to the TBOR Rules fulfill the Legislature's mandate in Mich. Comp. Laws Ann. § 205.4(3) that the amended rules provide: (i) standards for the fair and courteous treatment of taxpayers by the Department's contractors and agents; (ii) standards to ensure fair and consistent application of statutes and rules to taxpayers; and (iii) a requirement that Treasury not use collection goals or quotas during audits under the state Revenue Act or the Uniform Unclaimed Property Act. The amended rules update the requirements for a taxpayer's written designation of an authorized representative (also known as a "power of attorney" or "POA") to act on its behalf and to receive otherwise confidential taxpayer information. Michigan Department of Treasury Form 151, entitled "Authorized Representative Declaration (Power of Attorney)" is used for this purpose and for a taxpayer's designation of a representative to receive copies of certain letters and notices relating to a dispute under Mich. Comp. Laws Ann. § 205.8 . The amended rules clarify that the letters and notices are any written correspondence from the Department with content that relates to the audit, assessment, and/or collection of the respective tax type or that involves the appeal rights of the taxpayer under Mich. Comp. Laws Ann. § 205.22 . The amended rules identify actions the Department must take when it fails to send copies of letters and notices regarding a dispute to the taxpayer's designated official representative.

J. Laws Raising the Minimum Wage and Requiring Employers to Provide Paid Sick Leave. On September 5, 2018, the legislature passed two laws that will significantly impact Michigan employers. The first law raises the state’s minimum

wage, and the second requires employers to provide their employees with paid sick leave.

1. The new law raises the Michigan minimum wage from $9.25 per hour to $10 beginning January 1, 2019; $10.65 in 2020, $11.25 in 2021, and $12.00 in 2022. Starting in 2023, the minimum wage will be adjusted annually based on increases in the consumer price index.

2. The new "Earned Sick Time Act" requires the following:

a. Employees in Michigan will accrue at least one hour of paid sick time for every 30 hours worked;

b. Businesses with ten or more employees must provide at least 72 hours of paid sick time per year, while smaller employers are required to provide at least 40 hours of paid sick time; and

c. Employees who exhaust the annual minimums for paid time off are entitled to an additional 32 hours of unpaid earned sick time.

3. Employers must permit employees to use accrued paid sick time for a variety of reasons, including the employee's health; the employee's family member's health; the employee or employee's family member's need for time to deal with domestic violence including time to relocate and attend court proceedings; and meetings at a child's school related to the child's health, disability, of effects of domestic violence or sexual assault.

4. Notably, companies with any paid leave provisions as good as, or better than, those required by the Act are not required to develop an additional sick leave policy. Thus, even paid leave provisions that are not directed at sick time (for example, a paid vacation policy) satisfy the requirements of this Act as long as employees can use that paid leave for the purposes provided in the Act.

5. The Act also contains provisions specifying when medical documentation may be required from employees, when an employer may require prior notice from an employee of the need for leave, prohibiting retaliation for the use of paid sick time, and empowering individual employees and the State of Michigan to file lawsuits for violations of the Act.

6. By April 1, 2019, employers must notify all employees of the employer's sick time policy, that retaliation is prohibited, and that employees may file a civil suit or an administrative complaint for a violation of the new law. The law also includes a poster requirement.

IV. EMPLOYEE BENEFITS

A. 2018 Retirement Plan Limits.

Code Section	Explanation	2018	2017
402(g)(1) Elective Deferrals	Maximum amount employees can contribute to a 401(k) or 403(b) Plan	$18,500	$18,000
457(b)(2) and 457(c)(1) Limits	Maximum amount an employee and/or employer can contribute to a 457 Plan	$18,500	$18,000
414(v)(2)(B)(i) Catch-up Contributions	Additional amount those over age 50 can contribute to a 401(k) or 403(b) plan	$6,000	$6,000
414(q)(1)(B) Highly Compensated Employee Threshold	Compensation amount used to determine Highly Compensated Employees (Lookback year)	$120,000	$120,000
415(c)(1)(A) Defined Contribution Limits	Annual limit on all contributions (employee and employer) for 401(k) and 403(b) plans	$55,000	$54,000
Annual Compensation Limit	Maximum Compensation for Qualified Plan Purposes	$275,000	$270,000
Taxable Wage Base	Social Security wage base	$128,700	$127,200

B. Changes made by TCJA.

1. Extended Rollover Period for Loan Offsets. A loan offset due to plan termination or default due to termination of employment can be indirectly rolled over to another eligible retirement plan or IRA by the individual's tax filing deadline (including extensions) for the year of the offset.

a. Prior Law – A loan offset amount is generally eligible for rollover treatment, but the rollover must be completed under the standard rollover rules. As such, this amount is eligible for an indirect rollover to another qualified plan or IRA within 60 days to avoid taxation of the outstanding loan balance.

b. What Changed – A loan default due to (1) plan termination, or (2) severance from employment that results in a loan offset, may be indirectly rolled over by the individual's tax filing deadline (plus extensions) for the year of the loan offset.

c. When – Taxable years beginning after 2017.

d. Impacted Plans – Tax-qualified retirement plans, including 401(k), 401(a), 403(b), governmental 457(b) plans that offer loans.

2. Recharacterization of Roth Conversions. The bill eliminates the ability to recharacterize a Roth conversion after 2017.

a. Prior Law – Contributions and conversions to an IRA can be recharacterized to another type of IRA within the individual's tax deadline (plus extensions) for the year of the contribution/reconversion.

b. What Changed – The bill prohibits Roth conversions from being recharacterized after 2017. However, contributions to a traditional IRA can still be recharacterized to a Roth IRA (and vice versa).

c. When – Taxable years beginning after 2017.

d. Impacted Plans – IRAs (including rollover from a qualified plan to an IRA).

3. New Cost of Living Adjustment Index for IRA Limits. The bill changes the index used to determine the annual cost of living adjustment on IRA (including Roth IRA) contribution and deduction limits.

a. Prior Law – IRA limits were set by the CPI-U index.

b. What Changed – IRA limits are set by the chained CPI-U index, which is typically viewed as a slower inflation index.

c. When – Taxable years beginning after 2017.

d. Impacted Plans – Traditional and Roth IRAs.

4. 401(k) Hardship Withdrawals. Hardship withdrawals from a 401(k) plan to address a personal casualty loss of a principal residence may no longer be allowed unless the loss is attributable to a federally declared disaster area. The issue stems from changes that temporarily modify the deduction for personal casualty and theft losses under Code Section 165(h). Under the provision (found in section 11044 of the conference report), a taxpayer may now claim a personal casualty loss only if such loss was attributable to a disaster declared by the president under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act. These changes are applicable for tax years 2018 through 2025. Treasury regulations (Treas. Reg. §1.401(k)-1(d)(3)(iii)) list six "safe harbor" reasons (such as medical, education and funeral expenses and to prevent foreclosure) to permit plans to allow hardship distributions if the distribution is made to address an "immediate and heavy financial need of the employee." For a typical 401(k) plan that allows hardship withdrawals, one of the six reasons specifically cites Section 165 which references expenses for the repair of damage to the employee's principal residence that would qualify for the

casualty deduction under section 165 (determined without regard to whether the loss exceeds 10% of adjusted gross income).

5. Fringe Benefits.

<table>
<tr><th></th><th>2017 Expenses (Old Rules)</th><th>2018 Expenses (New Rules)</th></tr>
<tr><td>Office Holiday Parties
Summer Office Picnic</td><td>100% deductible</td><td>100% deductible</td></tr>
<tr><td rowspan="3">Entertaining Clients</td><td>50% deductible</td><td>Meals – 50% deductible</td></tr>
<tr><td>Event tickets, 50% deductible for face value of ticket; anything above face value is non-deductible</td><td rowspan="2">No deduction for entertainment expenses</td></tr>
<tr><td>Tickets to qualified charitable events are 100% deductible</td></tr>
<tr><td>Employee Travel Meals</td><td>50% deductible</td><td>50% deductible</td></tr>
<tr><td>Meals Provided for Convenience of Employer</td><td>100% deductible provided they are excludible from employees' gross income as de minimis fringe benefits; otherwise, 50% deductible</td><td>50% deductible (nondeductible after 2025)</td></tr>
<tr><td>Fringe Benefits</td><td>Businesses could deduct the cost of employee parking, transit passes and bike commuting reimbursements, and employees could exclude the benefit from income.
Employee achievement awards could consist of anything within a dollar limit of $400 per award and $1,600 for all awards to the employee for the year.</td><td>Businesses can no longer deduct the cost of employee parking and transit passes (bike commuting reimbursements are still deductible), but employees can still exclude the benefit from income, except bike commuting reimbursements.
Employee achievement awards must be tangible personal property and not cash, gift cards, coupons or certificates, nor tickets, meals, vacations, lodging or stocks and bonds. The dollar limits remain unchanged.</td></tr>
</table>

C. Changes made by the Budget Act. The two-year budget agreement that Congress passed on February 9, 2018, includes several tax policy changes affecting retirement plans.

1. Hardship Distributions.

a. The only amounts currently eligible for hardship withdrawal are elective deferrals (both pre-tax and Roth). Earnings on such deferrals may not be withdrawn on account of financial hardship (other than earnings accrued before 1989). Nor may a hardship withdrawal provision be applied to special types of employer contributions known as "qualified non-elective contributions" ("QNECs") or "qualified

matching contributions" ("QMACs"). All of these restrictions on hardship withdrawals will cease to apply as of the first plan year beginning after December 31, 2018.

b. Under current IRS guidance, any plan that wishes to take advantage of a regulatory safe harbor for hardship withdrawals must suspend a withdrawing employee's elective deferrals for a period of six months following the withdrawal. This suspension requirement also applies to the employee's after-tax contributions, and includes any employee contributions to other qualified and nonqualified plans, as well. The Budget Act directs the IRS to remove this requirement from the regulations. Thus, an employee who obtains a hardship withdrawal could continue contributing to the plan.

2. Loans. The current safe harbor also requires that a participant take all other available distributions before obtaining a hardship withdrawal. This requirement applies to participant loans, as well (to the extent a loan would not be taxable), and includes loans available under other qualified plans. The Budget Act removes the requirement that a participant obtain all available loans before obtaining a hardship withdrawal. It does not remove the requirement that a participant first obtain all other available distributions. Thus, to the extent a plan makes other types of contributions available for in-service withdrawal without a showing of financial hardship, a plan administrator would have to continue applying this restriction.

3. Form 1040SR. The IRS is required to publish a simplified income tax return form that can be used by taxpayers 65 or older. The legislation explains that the form will be similar to Form 1040EZ, but its use shall not be restricted because of the amount of taxable income or because the income for the tax year includes Social Security benefits, distributions from qualified retirement plans, annuities or other such deferred payment arrangements, interest and dividends, or capital gains and losses. The legislation states that the form shall be made available for tax years beginning after the date of enactment.

D. 2018 IRS VCP User Fees. IRS imposes user fees for requests for letter rulings, opinion letters, determination letters, advisory letters, and requests for approval of a plan or operational error under the Employee Plans Compliance Resolution System (EPCRS) — including the Voluntary Correction Program (VCP). Each January, it issues revenue procedures with rules for interacting with the agency to obtain these determinations, approvals, and advice. For the 2018 update in Revenue Procedure 2018-4, IRS made significant changes to the fees that will be charged for corrections made with a VCP filing. Unlike prior years, the 2018 VCP fee is determined by reference to net plan assets, and there are no reduced fees for minimum distribution, participant loan, or plan amendment failures. The updated schedule, effective January 2, 2018, is as follows:

- Plan assets of $0 to $500,000: VCP fee is $1,500
- Plan assets over $500,000 to $10,000,000: VCP fee is $3,000
- Plan assets over $10,000,000: VCP fee is $3,500

Small plans covering fewer than 101 participants paid $500 or $750 under the 2017 schedule, and will now pay at least $1,500 or $3,000 if the plan assets are over $500,000, under the 2018 schedule.

E. DOL Fiduciary Rule.

1. DOL Extends Transition Period for Fiduciary Rule Exemptions. The Department of Labor (DOL) extended the current Transition Period for the DOL Fiduciary Rule exemptions by 18 months. The Transition Period was scheduled to end on January 1, 2018, but now will end on July 1, 2019. During this extended Transition Period, the DOL will reexamine the Fiduciary Rule and exemptions to see if changes are warranted, and will coordinate with other regulatory entities, including the SEC, FINRA, and state insurance commissioners regarding the Rule. Under the fiduciary rule, without an applicable exception, any person providing "investment advice" with respect to employee benefit plans and arrangements covered by Title I of the Employee Retirement Security Act (ERISA) or Section 4975 of the Internal Revenue Code (the Code), including IRAs, will be considered a fiduciary with respect to such plan or arrangement. The DOL and the Internal Revenue Service had previously announced that through 2017 neither agency would seek enforcement (including, in the case of the IRS, for excise taxes) in connection with violations of the fiduciary rule against parties who are "working diligently and in good faith" to comply with the rule. The November 27 release confirmed that the DOL and IRS non-enforcement policies would continue until the end of the extended transition period, on July 1, 2019.

2. DOL Issues Temporary Enforcement Policy for Fiduciary Advice Rule. On May 7, 2018, the Department of Labor (the "DOL") issued a temporary non-enforcement policy regarding its investment advice fiduciary regulation (the "Fiduciary Rule") in Field Assistance Bulletin 2018-02. This guidance was issued in response to the action by the Court of Appeals for the Fifth Circuit to implement its opinion vacating the Fiduciary Rule and its related exemptions. *Chamber of Commerce of the United States of America, et al. v. DOL*, No. 17-10238 (5th Cir. Mar. 15, 2018). The DOL stated that from June 9, 2017, until additional guidance is issued, it will not pursue any actions "against investment advice fiduciaries who are working diligently and in good faith to comply with the impartial conduct standards for transactions that would have been exempted" in the Best Interest Contract Exemption or the Principal Transactions Exemption. Further, the DOL will not treat such investment advice fiduciaries as violating the prohibited transaction rules. Investment advice fiduciaries may rely on other available exemptions not affected by the Fifth Circuit's decision, but they are not required to do so. Finally, the DOL explained that it is continuing to consider what other types of temporary or permanent prohibited transaction relief is needed for investment advice fiduciaries. Unfortunately, the guidance does not provide any insight into how the DOL will approach the definition of investment advice fiduciary in the future. This is especially unclear given that the Securities and Exchange Commission released two proposed rules on April 18, 2018, designed to clarify the fiduciary duties that an investment adviser owes its clients under the Investment Advisers Act of 1940.

3. IRS Conformity. In March 2017 the IRS said in Announcement 2017-4, 2017-16 IRB 1106, that it would conform to the temporary enforcement policy first described by the DOL in Field Assistance Bulletin 2017-01 by providing relief from

some excise taxes under section 4975 and related reporting requirements for some individuals engaged in specified prohibited transactions. The fiduciary rule broadly reinterprets the term "investment advice fiduciary" and redefines exemptions concerning fiduciaries found in section 4975. Specifically, the announcement said the IRS wouldn't apply section 4975 and related reporting obligations for any transaction or agreement to which the DOL's temporary enforcement policy — or other subsequent related enforcement guidance — would apply.

F. Adoption Assistance Programs (IRC §137). The IRS announced in Revenue Procedure 2018-18 revised 2018 inflation-adjusted benefit amounts as the Tax Cuts and Jobs Act of 2017 ("Act") modified the index on which these benefit amounts are annually updated. The Act now requires the use of the chained CPI-U index for these parameters. These changes are retroactive to January 1, 2018. As revised, the 2018 amount that can be excluded from an employee's gross income for the adoption of a child with special needs has been lowered to $13,810 (originally $13,840) which is the same amount that can be excluded from an employee's gross income for the amounts paid or expenses incurred by an employer for qualified adoption expenses furnished pursuant to an adoption assistance program for other adoptions by the employee. The amount excludable from an employee's gross income begins to phase out under IRC §137(b)(2)(A) for taxpayers with 2018 modified adjusted gross income in excess of $207,140 (originally $207,580).

G. Determination Letter Program for Second Six-Year Cycle.

1. The IRS has announced (Announcement 2018-5) that starting May 1, 2018, and ending April 30, 2020, it will accept applications for individual determination letters from employers eligible to submit those requests under the second six-year remedial amendment cycle for defined benefit preapproved plans.

2. The IRS will issue opinion and advisory letters for preapproved — master and prototype and volume submitter — defined benefit plans that were restated for changes in plan qualification requirements listed in Notice 2012-76 (2012 Cumulative List). These plans also had to have been filed with the IRS during the submission period for the second six-year remedial amendment cycle under Rev. Proc. 2007-44. Employers using these preapproved plan documents to restate a plan for the qualification requirements included on the 2012 Cumulative List must adopt the plan document by April 30, 2020. The IRS expects to issue the opinion and advisory letters on or after March 30, 2018. The IRS will announce in future guidance a delayed beginning date for the third six-year remedial amendment cycle for preapproved defined benefit plans.

3. The IRS issued Rev. Proc. 2018-42, which modifies Rev. Proc. 2017-41, to extend the deadline for submitting on-cycle applications for opinion letters for pre-approved defined contribution plans for the third six-year remedial amendment cycle to December 31, 2018. Under Rev. Proc. 2017-41, this submission period was scheduled to expire on October 1, 2018.

H. IRS Rev. Proc. 2018-21 – Cash Balance Plans. This revenue procedure modifies Rev. Proc. 2015-36 to allow pre-approved defined benefit plans containing a

cash balance formula to provide for the actual rate of return on plan assets as the rate used to determine interest credits.

I. Pension Regulations Amend Qualified Contribution Definitions. The IRS has published final regulations (T.D. 9835) providing that employer contributions to a plan are qualified matching or nonelective contributions if they satisfy applicable nonforfeitability requirements and distribution limitations when they are allocated to participants' accounts rather than when they are contributed.

J. 401(k) Match for Student Loan Repayments. On August 17, 2018, the IRS made public PLR 201833012, which was issued to the requesting company on May 22, 2018. The letter responds to an unnamed employer that proposed amending its 401(k) plan to offer a student-loan benefit program under which it would make special 401(k) contributions into the accounts of employees who are making student loan repayments.

1. The IRS approved the proposed nonelective contribution structure, which contained the following features:

a. The plan would provide a 5% employer nonelective contribution per pay period for any eligible employee who made a student loan repayment equal to at least 2% of his or her compensation during that pay period. The nonelective contribution would be made for each pay period during which an employee made a sufficient student loan repayment, even if the employee did not consistently make student loan repayments throughout the plan year.

b. The nonelective contribution would be offered in addition to the plan's matching contribution, and would be provided regardless of whether an employee made any elective deferrals.

c. Although an employee could continue making elective deferrals while receiving the nonelective contribution, the employee could not receive a matching contribution in addition to the nonelective contribution with respect to any pay period. If an employee was prohibited from receiving a matching contribution due to receipt of the nonelective contribution, the plan would make a "true-up" contribution. The true-up contribution (equal to 5% of the employee's compensation) would be paid for any week an employee failed to make a sufficient student loan payment but did make an elective deferral equal to at least 2% of his or her compensation.

d. The nonelective contributions and true-up matching contributions would be subject to the same vesting schedule as matching contributions. Also, the nonelective contribution would be subject to all plan qualification requirements, including eligibility, distribution rules, contribution limits, and coverage and nondiscrimination testing.

e. The proposed student loan repayment contribution program would be completely voluntary, meaning an employee would need to elect to enroll, and once enrolled could opt out of the program on a prospective basis. All employees eligible to participate in the plan would be eligible for the program. The nonelective

contribution and true-up contribution, if applicable, would be made as soon as practicable after the end of the plan year.

f. The nonelective contribution will not be treated as a matching contribution for purposes of Internal Revenue Code Section 401(m) testing, but the true-up contribution will be included for any testing or other requirement under that Code provision.

g. The plan sponsor had not extended, and would not extend, student loans to employees who were eligible to participate in the student loan repayment contribution program.

2. In finding that the nonelective contribution structure did not violate the contingent benefit prohibition, the IRS noted that the nonelective contribution was conditioned on an employee making student loan payments outside of the plan (rather than being conditioned on the employee making elective deferrals). The IRS also found relevant the fact that employees could still make elective deferrals to the plan while participating in the student loan repayment contribution program. This meant the nonelective contribution was not conditioned upon employees having to choose between the employer making or not making contributions for them under the program in lieu of regular taxable wages.

K. New Law Makes SBA ESOP Financing Easier. On August 13, 2018, the Main Street Employee Ownership Act (MSEOA) became law. The new law encourages the creation of ESOPs and worker cooperatives by facilitating transactions via loans supported by the Small Business Administration (SBA). It also directs the SBA's outreach infrastructure to encourage business owners to consider employee ownership.

L. Executive Order. An executive order signed on August 31, 2018, directs Treasury to consider amending rules related to multiple employer plans, review ways to reduce the costs and burdens of retirement plan disclosures for employers, and examine the life expectancy and distribution period tables used to determine required minimum distributions to see if they should be updated.

M. Extension of Nondiscrimination Relief to Certain Closed Defined Benefit Plans.

1. The Internal Revenue Service (IRS) has again extended the temporary nondiscrimination relief for closed defined benefit plans. This extended relief is intended to enable closed pension plans (defined as pension plans that have been closed to new participants before December 13, 2013 but continue to provide ongoing benefit accruals for certain participants) to more easily satisfy certain nondiscrimination testing requirements. In most cases where the relief applies, the closed defined benefit plan is aggregated with a defined contribution plan to satisfy the nondiscrimination testing requirements. The relief assists the aggregated plan in passing nondiscrimination requirements that apply to accrued benefits and to certain rights and features relating to those benefits.

2. The original nondiscrimination testing relief for closed pension plans was provided in a 2014 IRS Notice. This relief was already extended on three prior occasions, and the most recent IRS Notice further extends the relief until the end of plan years that begin before 2020, as long as the conditions of the original 2014 IRS Notice continue to be satisfied. In 2019, the IRS also intends to issue final regulations under Section 401(a)(4) of the tax code that address the nondiscrimination requirements for closed pension plans. Until then, the IRS indicated that plan sponsors can rely on the proposed 2016 IRS regulations under Section 401(a)(4) for plan years that begin before 2020.

V. HEALTH CARE

A. TCJA Removes the Affordable Care Act Penalty. Under the Affordable Care Act (ACA), taxpayers who do not have minimum essential health insurance coverage or qualify for an exemption were required to pay a penalty on their tax return (there are actually two penalties at issue: the section 4980H(a) penalty for not providing minimal essential coverage to 95 percent of full-time employees, and the section 4980H(b) penalty for coverage that isn't affordable or doesn't meet the minimum value requirement for one or more employees). For tax years 2016, 2017, and 2018, the penalty is the greater of $695 per individual (up to a maximum of $2,085) or 2.5% of household income, less the taxpayer's filing threshold amount. Taxpayers who are eligible to claim a penalty exemption file Form 8965 with their tax return. The IRS receives information about health coverage from health insurers and employers. They send Form 1095-A, Form 1095-B, and Form 1095-C to taxpayers and the IRS. These forms show whom was covered and also let the IRS know if coverage lasted all year or part of the year. The Tax Cuts and Jobs Act of 2017 (TCJA) eliminates the Affordable Care Act penalty beginning in tax year 2019.

B. Health Savings Accounts (IRC §223).

1. Revenue Procedure 2018-18. The IRS announced in Revenue Procedure 2018-18 revised 2018 inflation-adjusted benefit amounts as the Tax Cuts and Jobs Act of 2017 ("Act") modified the index on which these benefit amounts are annually updated. The Act now requires the use of the chained CPI-U index for these parameters. These changes are retroactive to January 1, 2018. As revised, the annual contribution limit for coverage other than self-only coverage has been lowered to $6,850 (originally $6,900). All other HSA-related limits remain the same and are as follows:

2018

Annual Contribution Limit	
Self-Only Coverage	$3,450
Family Coverage	**$6,850**
Annual Deductible for Qualified High Deductible Health Plan	
Self-Only Coverage	$1,350
Family Coverage	$2,700
Maximum Annual Out-of-Pocket Limit	
Self-Only Coverage	$6,650
Family Coverage	$13,300

2. IR-2018-107. The IRS subsequently announced (IR-2018-107) relief for taxpayers with family coverage under a high deductible health plan (HDHP) who contribute to a health savings account, allowing them to treat $6,900 as the maximum deductible HSA contribution for 2018.

3. Revenue Procedure 2018-30. For 2019, the HSA contribution limit for a self-only HSA is $3,500 (a $50 increase from calendar year 2018) and $7,000 for a family HSA (a $100 increase from calendar year 2018). To qualify as an HDHP in 2019, a plan must have a minimum annual deductible of at least $1,350 for self-only coverage (no change), and $2,700 for family coverage (no change). The maximum out-of-pocket expenses permitted for an HDHP is $6,750 for self-only coverage (a $100 increase) and $13,500 for family coverage (a $200 increase).

C. Michigan HICA Tax Repeal. On June 11, 2018, Governor Snyder signed a series of bills that repeal the Michigan Health Insurance Claims Assessment (HICA) tax. The legislation includes a proposed replacement tax, the Investment Provider Assessment (IPA). The HICA tax imposes a 1% tax on all paid health claims in the State of Michigan, including those claims paid by fully insured and self-funded group health plans. (The 1% was lowered to .75% from July 1, 2014 until December 31, 2016.) Account-based group health plans (e.g., HRAs, health FSAs, HSAs) were excluded from the HICA tax. Technically, the HICA tax was imposed on the carriers of fully insured group health plans and the TPAs of self-funded group health plans. But those costs were certainly shifted to employer-plan sponsors of group health plans. The IPA — if approved by CMS — is a three-tier tax on insurance providers:

- First-tier: Medicaid managed care organizations would be subject to a variable- and fixed-rate tax. The variable-rate would be established each year by the Michigan Department of Health and Human Services (MDHHS) and apply to a specified number of “member months,” which is also annually established by the MDHHS. Any member months in excess of the number specified by MDHHS would be subject to a fixed-rate of $1.20 per member month.

- Second-tier: Health insurers (which include any insurer authorized to deliver a health insurance policy in Michigan and HMOs) would be subject to a fixed-rate of $2.40 per member month for all member months not supported by Medicaid funds.

- Third-tier: Prepaid Inpatient Health Plans (PHIPs) would be subject to a fixed-rate of $1.20 per member month for all member months not supported by Medicaid funds.

Assuming a favorable determination by CMS, the HICA tax will be repealed and the IPA will be effective on the later of: (i) the first day of the calendar quarter during which MDHHS is notified that its waiver request is approved by CMS; and (ii) October 1, 2018.

D. Michigan Reduces Tax Rate on Gross Direct Premiums from Qualified Health Insurance Policies. L. 2018, S1016 (P.A. 222), effective 01/01/2019

and operative as shown, reduces the corporate income tax rate on gross premiums attributable to qualified health insurance policies from 1.25% to 0.95% for the period January 1, 2019 through December 31, 2019. The bill provides that for the 2020 tax year and subsequent tax years, the rate on such gross premiums will be determined according to a formula that would cap the total tax reduction per year at $18.0 million. The bill requires the State Treasurer to develop a method to account for changes in tax liability occurring after the calculation of the immediately succeeding calendar year's rate.

E. Paid Family and Medical Leave Tax Credit. The IRS has issued FAQs that provide guidance to employers on the Paid Family and Medical Leave Tax Credit which was created by the Tax Cuts and Jobs Act of 2017.

1. The FMLA Tax Credit, as provided under Internal Revenue Code Section 45S, enables eligible employers to claim a general business tax credit of up to 25 percent of the wages paid to qualifying employees while they are on family and medical leave, subject to certain conditions.

2. To qualify for the FMLA Tax Credit, the employer must have adopted a written leave policy that meets certain requirements, including: (i) provision of at least two weeks of paid family and medical leave (annually) to all qualifying employees who work full-time (prorated for employees who work part- time); and (ii) paid leave that is not less than 50 percent of the wages normally paid to employees.

3. A qualifying employee is any employee under the Fair Labor Standards Act who has been employed by the employer for one year or more and who, for the preceding year, had compensation of not more than a certain amount. For an employer claiming a credit for wages paid to an employee in 2018, the employee must not have earned more than $72,000 in 2017.

4. The FAQs clarify that, for purposes of the FMLA Tax Credit, "family and medical leave" is leave for one or more of the following reasons:

- Birth of an employee's child and to care for the child.
- Placement of a child with the employee for adoption or foster care.
- To care for the employee's spouse, child, or parent who has a serious health condition.
- A serious health condition that makes the employee unable to perform the functions of his or her position.
- Any qualifying exigency due to an employee's spouse, child, or parent being on covered active duty (or having been notified of an impending call or order to covered active duty) in the Armed Forces.
- To care for a service member who is the employee's spouse, child, parent, or next of kin.

5. One difference between the rules for the tax credit and for FMLA leave in general is that, if an employer provides paid vacation leave, personal leave, or medical or sick leave (other than paid leave specifically for one or more of the purposes stated above), that paid leave is not considered family and medical leave for purposes of the tax credit. Moreover, any leave paid by a state or local government or required by state or local law will not be taken into account in determining the amount of the tax credit.

6. An employer must reduce its deduction for wages or salaries paid or incurred by the amount determined as a credit. Also, any wages taken into account in determining any other general business credit may not be used in determining this credit.

7. The FMLA Tax Credit is generally effective for wages paid in taxable years of the employer beginning after December 31, 2017. It is not available for wages paid in taxable years beginning after December 31, 2019.

F. ADA and GINA Regulations from the EEOC on Wellness Programs. Last year, litigation overturned the EEOC's GINA and ADA regulation on limiting wellness program rewards. The EEOC was directed instead to update the court regarding when it would remedy the deficiencies in its regulatory process with respect to these regulations. The EEOC recently filed a status report indicating that it will not issue new proposed regulations addressing the deficiencies in the earlier regulation by the original date scheduled by the court for this August. Since there will be no new ADA and GINA proposed or final regulations on wellness programs by this August, it is highly unlikely that there will be any changes mandated to wellness programs for 2019. The regulatory process requires significant time.

VI. ESTATE PLANNING

A. Changes made by TCJA.

	Old 2018 Rules (under prior law)	New 2018 Rules (under Tax Cuts and Jobs Act)
Federal Estate, Gift and GST Tax Exemption Equivalents	$5.6 million ($5 million indexed for inflation)	$11,180,000 ($10 million indexed for inflation[1]), with further inflation adjustments in subsequent years through December 31, 2025 Starting January 1, 2026 - exemptions scheduled to revert to prior $5 million amounts, indexed for inflation
Highest Federal Marginal Estate, Gift and GST Tax Rate	40%	40%
Per Donee Gift Tax Annual Exclusion	$15,000 ($10,000 indexed for inflation)	$15,000 ($10,000 indexed for inflation[1])

Gift Tax Exclusion for Direct Payment of Qualified Tuition and Medical Expenses	Yes	Yes
Spousal Portability at Death of Deceased Spouse's Unused: ***Estate/Gift Tax Exemption*** ***GST Tax Exemption***	 Yes No	 Yes No
Gift and Estate Tax Marital and Charitable Deductions	Yes	Yes
Federal Estate Tax Deduction for State-Level Estate Taxes Paid	Yes	Yes
Valuation Discounts, Family Loans at Applicable Federal Rate, "Zeroed Out" GRATs, Qualified Personal Residence Trusts, Charitable Lead and Remainder Trusts, "Perpetual" GST Tax Exempt Trusts and Income Tax "Grantor Trusts" Permitted	Yes	Yes
"Step-Up" in Income Tax Basis for Property Passing at Death[2]	Yes	Yes

1 The relevant inflation adjustment provisions were modified as part of the final changes to the Act prior to its passage by Congress. While official calculations have not been released, we do not expect the change to be material for 2018.

2 Except for items of "income in respect of a decedent" (e.g., inherited traditional IRA).

B. Rollover of Plan Distribution from Estate is Tax-Free. In PLR 201821008, The IRS ruled that a distribution from a decedent's estate to the surviving spouse will be treated as having come directly from the decedent's retirement plan and that the spouse, who was eligible to roll over the amount to her own IRA, won't have to include the funds in her gross income. In this case, Decedent's estate was the beneficiary of his account in the Plan, and his account was paid by the Plan to the estate in a lump sum (net of taxes withheld on the distribution). Taxpayer, Decedent's surviving spouse, was the executor and sole beneficiary of Decedent's estate, and promptly distributed the amount received from the Plan to herself. Taxpayer then deposited the amount distributed from the Plan (including both the net amount the estate received from the Plan and an amount equal to the taxes withheld on such distribution) into IRA X within 60 days of the date such amount was distributed from the Plan.

C. Proposed Section 199A Regulations - Anti-Abuse Provisions for Trusts. The proposed Section 199A regulations utilize the authority granted by section 643(f) to prevent taxpayers from establishing or funding multiple non-grantor trusts in order to increase the Section 199A deduction. Section 643(f), enacted in 1984, grants Treasury authority to issue regulations treating two or more trusts as a single trust if (1) the trusts "have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries" and (2) "a principal purpose" of the trusts is the

avoidance of income tax. For purposes of applying this section, spouses are treated as one person.

VII. MERGERS & ACQUISITIONS

A. Choice of Entity after TCJA.

1. C Corporation Advantages. C corp income is taxed at a flat 21% rate whereas partnership income flowing through to an individual partner is subject to tax at a maximum 37% rate. In addition, C corps can fully deduct state and local taxes whereas an individual's deduction is limited to a maximum of $10,000.

2. Pass-Through Advantages. Pass-through income (e.g., S corporation or partnership) may be eligible for a 20% deduction for qualified business income (QBI), but that still leaves the effective tax rate at 29.6% (i.e., higher than the C corp 21% tax rate). Furthermore, the 20% QBI deduction is not allowed for most service businesses (except for partners or S corp shareholders whose taxable income is less than $315,000 ($157,500 if not married filing jointly), with the benefit phased out over that amount so it is totally lost once the partner's taxable income equals $415,000 ($207,500 if not married filing jointly). There are also other limitations that only generally allow the QBI deduction to be claimed if the business employs many people or owns depreciable tangible property (such as real estate).

3. Two Levels of Tax. The drawback to C corps, of course, is that they are subject to two levels of taxation, one at the corporate level on earnings and one at the shareholder level, for example, on dividends. Dividends usually are taxed at the qualified dividend rate of 20%, though there is usually no preferential tax rate at the state and local level. Dividends also may be subject to the 3.8% net investment income tax. If only federal taxes are considered, the effective federal double tax rate is 39.8%. This may be the deciding factor for many businesses. If a business does not make distributions to its owners (for example, the owners generally take only salary and perks and profits are reinvested), then a C corp structure may result in income tax savings. On the other hand, if the business distributes all of its profit out to its owners annually, then the double tax resulting from a C corp structure will be disadvantageous.

4. Accumulated Earnings and PHC Tax. If the C corp accumulates cash, it can be subject to one of two penalty tax regimes – accumulated earnings tax and personal holding company tax. Closely held C corps are subject to the personal holding company tax if 60% or more of their income is passive income, which they retain in the C Corp and do not distribute to their shareholders, though the personal holding company tax often can be avoided. In addition, a C corp is subject to the accumulated earnings tax if it accumulates earnings beyond the reasonable needs of the business.

5. Sale of Company. If a company is sold, it is most often structured as an asset sale, which results in two levels of tax for a C corp – one tax to the corporation when it sells its assets in exchange for cash (or a note, etc.) and a second tax if the corporation is liquidated and the stockholders exchange their (low basis)

shares for the sale proceeds. For a company that may be sold in the near future, C corp status would be disadvantageous. On the other hand, if there are no plans to sell the company (e.g., there are children in the business), this may not be a concern. The owner may consider whether he or she can own goodwill, client lists or other intangible assets in his or her own name rather than in the corporation to avoid double tax. See Martins Ice Cream, Norwalk, and related tax cases on "personal goodwill."

6. Step-up at Death. If an owner dies owning C corp stock, the stock will receive a step-up in basis to its fair market value. This will avoid a shareholder level tax if the C corp liquidates. However, it does not avoid a tax to the corporation on any appreciated assets that are distributed in liquidation or later sold by the C corp.

7. Losses. If a partnership has losses that flow through to its partners, those losses would not flow through if the entity becomes a C corp, so C corp status would be disadvantageous.

8. Timing and Related Issues. A company that is an LLC can elect to be treated as a corporation for tax purposes. If a decision is made to terminate S corp or partnership status, then termination would have to be completed by March 15, 2018, to be effective this year. Also, an S corporation that terminates its S status has a five year waiting period to convert back to S status. If the C corp converts to S corp status in the future, then it may be subject to a built-in gain tax and other concerns if it later converts to an S corp and has accumulated earnings and profits. If an S corp converts to a C corp, there is a two-year post termination period to take out AAA. The Tax Reform bill provides that distributions within this period will be partly treated as AAA (tax-free) and partly treated as previous C corp E&P (taxable 23.8% dividend). Also, given the uncertainty surrounding TCJA and the possibility that the rules could be changed again, some business owners may be reluctant to convert to C corp status and then get "stuck" if the rates or rules change.

9. Outbound Foreign. Under the new international tax rules, ownership of foreign corporations by a C corp rather than an individual has several advantages. Dividends paid by a foreign corporation to a C corp can escape any tax while dividends paid to an individual are fully taxable. If a foreign corporation has income that exceeds a base threshold amount (generally, 10% of the book value of its assets) and the foreign corporation does not distribute those excess earnings to its U.S. shareholder, then the new "GILTI" tax applies to treat the U.S. shareholder as receiving a deemed taxable dividend of that excess amount. But C corps pay a lower tax rate on this income or may not pay any tax at all.

B. Expensing Eligibility and Spinoff Transactions.

1. Under section 168(k), taxpayers can write off the asset basis with 100 percent bonus depreciation for qualifying new assets and newly acquired used assets for property acquired and placed in service between September 27, 2017, and January 1, 2023. The phaseout period begins in 2023, allowing 80 percent of the adjusted basis of qualified property placed in service, and the rate is reduced by 20 percent in each subsequent year. That provision creates planning opportunities for subchapter C corporations that could purchase another corporation, make a section

338(h)(10) election, and potentially be eligible for full expensing of all the qualified property of the acquired company.

2. In a section 338(h)(10) transaction, there is a deemed sale of assets by the target subsidiary and a deemed purchase of assets by the newly reconstituted acquiring company. With full expensing, the seller would not have any basis in the assets with the write-off occurring in the first year, and so the seller would have deemed sale gain to the full market value of the target. The buyer acquires immediate basis with an immediate write-off.

3. For purposes of a section 338(h)(10) election, the buyer and seller of stock can't be related. Section 168(k) offers a similar restriction to the buyer and seller of assets.

4. Example: A distributing corporation contributes target stock to NewCo in exchange for NewCo common and preferred stock. "Pursuant to a binding contract," the distributing corporation sells the NewCo preferred stock to an unrelated third party. The distributing corporation and NewCo make a section 338(h)(10) election for the target. The distributing corporation contributes NewCo and other active trades or businesses to a controlled entity and distributes the stock in a section 355 spinoff transaction. The section 168(k) bonus depreciation rules contain related party limitations that cross-reference section 179, which looks to the buyer and seller of the asset, and section 338 related party rules, which apply to the buyer and seller of the stock. In the example, the buyer and seller of the stock are unrelated. Under the section 338 regulations, the new target is treated as a new corporation that is unrelated to the] old target for purposes of subtitle A," which includes section 168(k), which suggests that this transaction works to obtain a stepped-up basis.

C. Safe Harbors Provided for Continuity of Interest Purposes. Rev. Proc. 2018-12, 2018-6 IRB 1, released January 23, provides three safe harbor methods of measuring the value of stock for the continuity of interest rules by taking an average over a measurement period rather than the value on one specific date.

D. Inaugural Spinoff Transactional Ruling. In the past, the IRS permitted taxpayers to submit ruling requests on the entire spinoff-related transaction except for factual issues surrounding device, business purpose, and whether a plan exists under Section 355(e). However, since August 2013, the IRS had limited spinoff rulings (Rev. Proc. 2013-32, 2013-28 IRB 55) to selected "significant issues." It expanded the program in September 2017 (Rev. Proc. 2017-52, 2017-41 IRB 283) to include some transactional rulings. The 18-month pilot program, which ends March 21, 2019, covers distributions taxpayers intend to qualify as tax free under sections 355(a) and 355(c), along with D/355 spinoff transactions. Under the pilot program, the onus shifts from the IRS to the taxpayers to identify where they deviate from the standard representations, simplifying the process for the IRS and enabling it to focus on those differences. In the inaugural letter ruling, PLR 201827006, the agency allowed differences from some of the 46 standard representations.

VIII. REAL ESTATE

A. Impact of TCJA.

1. Tax Rate. The reduction in corporate tax rates will impact yield and reduce equity pricing on tax credit investments such as the low income housing tax credit ("LIHTC").

2. 20% Pass-Through Deduction. Given the language of the statute, a determination of whether a particular business constitutes a qualified trade or business can be quite nuanced and require interpretation of rulings and other precedent issued under existing Code Section 1202(e)(3)(A). Taxpayers who operate management, maintenance, landscaping and similar businesses will need to consider their situation very carefully. For example, is their business excluded because it constitutes a trade or business where the principle asset of such trade or business is the reputation or skill of one or more of its employees or owners?

3. Limitation on Business Interest Deduction.

a. In general, the deduction for business interest is effectively capped at the sum of business interest income plus 30% of earnings (generally calculated as EBITDA for four years, and EBIT thereafter). Interest not allowed as a deduction is to be carried forward for five years.

b. A "real property trade or business" (meaning any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business) may elect to be exempt from the business interest deduction limitation. Any such election shall be made at such time and in such manner as the Secretary shall prescribe, and, once made, shall be irrevocable. An electing real property trade or business is required to depreciate its real property under the alternative depreciation system (which generally requires longer methods of depreciation recovery).

c. The business interest deduction limitation is determined at the partnership, not the partner level. Whether a particular real estate partnership should elect to be exempt from the business interest deduction limitation will have to be determined on a case-by-case basis. In the case of an equity fund that invests in real estate partnerships, an election out of the business interest limitations would only be applicable with respect to interest on indebtedness incurred by the equity fund itself, such as bridge financing to meet operating-tier capital contribution obligations prior to the receipt of corresponding capital contributions from investors in the fund. However, it is not clear whether the interest on such indebtedness could be characterized as incurred in connection with a real estate trade or business, as the equity fund is not acquiring or operating real estate – it is acquiring interests in pass-through entities that own and operate real estate.

d. The limitation on interest deductions does not apply to businesses with average gross revenue of $25 million or less for the past three years. The small business exemption is satisfied if the corporation or partnership in question is

not a tax shelter (within the meaning of Code Section 448(a)(3)) and has average annual gross receipts of less than $25 million for the three previous taxable years (or such shorter period in which such corporation or partnership was in existence). Many real estate partnerships will not qualify for the small business exemption because the term "tax shelter" for this purpose includes a partnership in which more than 35 percent of its losses are allocated to limited partners.

4. Carried Interest.

a. Under TCJA there is a three-year holding period in order to qualify for long term capital gains rates with respect to profits interests held in connection with the performance of services in the business of raising or returning capital and either (i) investing in stocks, securities or real estate held for rental or investment or (ii) "developing" such assets.

b. The three-year holding period applies both at the carried interest level and at the partnership asset level – meaning that a sale of the carried interest or of an asset held by the partnership within three years of acquisition could result in short-term capital gain to a holder of the carried interest.

c. Although most promote interests are held for longer than three years (and thus should not be impacted by this change), capital gains in respect of real estate investments disposed of within the three years of the investment may be subject to these limitations.

5. Expensing Capital Improvements.

a. Section 168 permits taxpayers to claim bonus depreciation equal to 100% of the cost of certain qualified property acquired and placed in service after September 27, 2017. Bonus depreciation phases out from 2023 through 2026.

b. Section 179 permits taxpayers to expense up to $1 million of the cost of certain depreciable property (including qualified real property) acquired and placed in service by a trade or business. For purposes of Section 179, "Qualified Real Property" generally includes the following:

i. Any improvements to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service (other than expenditures attributable to enlargement of a building, any elevator or escalator, or the internal structural framework of a building); and

ii. Any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service:

- Roofs.
- Heating, ventilation, and air-conditioning property.
- Fire protection and alarm systems.
- Security systems.

6. Real Property Depreciation.

a. Cost recovery periods for residential and nonresidential real property remains unchanged (27.5 years and 39 years).

b. Alternative depreciation recovery period for residential rental property is shortened from 40 years to 30 years.

i. For residential rental property and nonresidential real property placed in service after December 31, 2017, the alternative depreciation recovery periods are 30 and 40 years, respectively. It is not clear whether the applicable recovery period for existing residential rental property held by an electing real property trade or business will be based on the new recovery period for alternative depreciation provided in the TCJA (30 years) or the longer 40 year recovery period in effect under prior law.

ii. Under prior law, partnerships with non-profit general partners were often required to provide for "qualified allocations," limit annual fees to fixed amounts, or admit a wholly owned subsidiary of the non-profit as the general partner and make a Code 168(h)(6)(F) election unless investors were willing to accept 40-year depreciation. Investors may be willing to tolerate more flexibility under the new law in cases such as LIHTC projects where the consequence of having a portion of the property being treated as tax exempt use property will be limited to the difference between a 30-year and 27.5-year recovery period.

7. Like Kind Exchanges. Like-kind exchange treatment limited to exchanges of real property not held primarily for sale. Exchanges of personal property for personal property no longer qualify.

8. Net Operating Loss Limitations.

a. NOLs are deductible only to the extent of 80% of the taxpayer's taxable income starting in 2018.

b. While NOLs may be carried forward indefinitely, there will be no carrybacks of NOLs.

c. These rules are only effective for NOLs arising in taxable years beginning after 2017.

d. Existing NOLs are subject to the rules in existence prior to the enactment of the TCJA (i.e., may be carried back 2 years, carried forward 20 years, and offset 100% of taxable income).

e. Newly created NOLs will not be as valuable as they have been in prior years, and taxpayers that engaged in taxable transactions in 2017 with the idea that they would be able to carryback future NOLs to offset any income triggered will not be able to do so.

9. Partnership Technical Terminations.

a. The partnership technical termination provisions of Code Section 708(b)(1)(B) are repealed.

b. Repeal of the technical termination rule will avoid having to restart depreciation and file short taxable year returns in connection with a sale of a partnership interest would have otherwise given rise to a technical termination.

B. New Section 199A and Like-Kind Exchanges. Section 199A limits the pass-through deduction by wages paid to employees and 2.5 percent of the unadjusted basis in property immediately after acquisition. The "unadjusted basis" language has led to uncertainty surrounding how the IRS will determine which amount in a like-kind transaction will be taken into consideration in applying the limitation. For example, a taxpayer could purchase real estate and depreciate it over time, and instead of later selling it, that taxpayer could exchange the property and defer capital gain. If the taxpayer exchanged the property for replacement property, it would take a carryover basis in the new property to avoid doubling up on depreciation deductions. If the IRS also used the carryover basis in the replacement property in applying the Section 199A unadjusted basis limitation, it would arguably burden taxpayers. Real estate industry groups have argued the regulations should use the cost basis of the replacement property, which relies on the fair market value of the replacement property, to determine the unadjusted basis limitation.