OUR THOUGHTS ON...
TAX CUTS
AND JOBS ACT
The Tax Cuts and Jobs Act will impact every individual and organization differently. While this document provides extensive detail on the new tax legislation, it is not intended to be comprehensive. We encourage you to reach out to your Schneider Downs representative for a more specific discussion about changes that will impact you or your organization. We look forward to hearing from you.

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This advice is not intended or written to be used for, and it cannot be used for, the purpose of avoiding any federal tax penalties that may be imposed, or for promoting, marketing or recommending to another person, any tax-related matter.
Schneider Downs Tax Advisors is pleased to introduce Our Thoughts On the Tax Cuts and Job Act. On the following pages, we will highlight many of the changes that we believe will be most impactful for our clients. It is our hope this will begin a dialogue with you. After reviewing Our Thoughts, we invite you to contact your Schneider Downs advisor to schedule a more in-depth discussion about how you will be affected.

On December 22, 2017, President Trump signed into law H.R. 1 officially identified as “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018” (the Act). The Act was formerly known as, and is still informally referred to as, the Tax Cuts and Jobs Act.

The Act may be the most comprehensive change in tax law since the 1986 Tax Reform Act. Commentators are calling the changes “a historic overhaul of the U.S. tax system.” The label “historic” may be overstating the long-term impact, since many of the Act’s provisions are scheduled to be phased out. The temporary nature of many of the provisions will require lawmakers to readdress these changes in the future.

The legislation brings significant changes to individual taxpayers, “C” corporations, flow-through entities, trusts and estates and tax-exempt organizations. Highlights of the Act include:

- A permanent reduction in the tax rate of “C” corporations to a flat 21%;
- A permanent limitation in the deductibility of business interest expense;
- A temporary deduction providing for the immediate expensing of capital investment in tangible property;
- A temporary new deduction for “domestic qualified business income” available to individuals, trusts and estates;
- A temporary reduction in individual tax rates;
- The temporary elimination of, or reduction of, state and local taxes, mortgage and home equity interest, miscellaneous itemized, and personal exemptions deductions by individuals;
- Permanent new taxes levied against tax-exempt organizations; and
- Fundamental tax changes to taxpayers conducting business globally.

Although tax reform has been a topic of political discussion for years, both the magnitude of the Act and the speed at which the law was drafted, negotiated and enacted has left in its wake many questions that will require interpretation, clarification and corrective legislation. The final few days of 2017 provided a glimpse into the reality of reform. As an example, the amount of press given to, and the angst felt by many individuals, regarding the ability to deduct real estate taxes paid by year-end was surreal in many respects. The effort by many to take advantage of a potential deduction, which may not have been available even without the last-minute guidance issued by the IRS generally disallowing the deduction, is but one indication of the uncertainty faced by both taxpayers and tax professionals in dealing with the Act. Multiply that
one small item by the dozens of provisions in the Act, the magnitude of which has not been seen in decades, and you have a high level of engagement, concern and uncertainty shared by millions of taxpayers.

There has been a call for technical corrections legislation that could result in changes to many of the Act’s provisions. The issuance of regulations, and other guidance to provide clarification, will “tax” the capacity of the resource-strained Internal Revenue Service.

Although the Act appears to affect all taxpayers in some manner, its impact will not be felt equally. Nor could it be, given the task facing legislators to enact corporate tax reform in an effort to make the U.S. corporate tax system more competitive globally, and to provide some benefit to all constituents, all while trying to minimize the impact to the nation’s deficit.

Economists argue that all taxes are ultimately paid for by individuals. For the individual taxpayer, the Act’s impact will depend upon various factors, including the amount and types of income earned, the number of and ages of any children or other dependents, the states and cities in which the taxpayers live and/or work, the types of assets owned, and even when they die. All taxpayers will need to identify and consider all of the provisions to ultimately calculate the Act’s overall current and future impact. Our guide is not meant to be an exhaustive, in-depth analysis of every new provision or change resulting from the Act. Rather, it is meant to serve as an introduction to the provisions we believe will impact you and to stimulate conversations and consultations with your Schneider Downs advisors.

With change comes opportunity. Our commitment to providing “Big Thinking with a Personal Focus” involves our efforts to identify opportunities amid the uncertainty of these times. Your team at Schneider Downs looks forward to working together with you to help make informed decisions for you and your organization. Let’s get to work.

Schneider Downs & Co., Inc.
Tax Technical Committee

**Additional Tax Reform Resources Located on the Schneider Downs Website**
- Schneider Downs Tax Reform Blog
- H.R. 1 – Full text of the Tax Cuts and Jobs Act
- The Conference Agreement (prepared by the staff of the Joint Committee on Taxation)
- Joint Committee on Taxation Estimated Budget Effects of the Conference Agreement
- Joint Committee on Taxation Distributional Effects of the Conference Agreement for H.R. 1
- Joint Committee on Taxation Macroeconomic Analysis of the Conference Agreement
- The Congressional Budget Office Cost Estimate for the Conference Agreement
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The majority of the Act’s provisions affecting individuals are temporarily effective for the period of January 1, 2018 through December 31, 2025. In addition to across-the-board tax rate reductions, the major changes of the Act include increasing the standard deduction and eliminating certain itemized deductions and personal exemptions. The new law enhances the child tax credit and creates a new dependent tax credit, and preserves many other popular credits. The new law does not eliminate alternative minimum tax (AMT) calculations for individuals but does increase the AMT exemption and phase-out amounts.

Individual tax rate brackets, the standard deduction, and other items are indexed for inflation. However, the Act requires a “chained CPI” methodology that takes into consideration consumer choices to use less-expensive substitute versions of products during periods of inflation. This method will likely result in smaller increases to amounts subject to annual inflationary adjustments and is one of the permanent items impacting individual taxation.

The Act introduces a new pass-through business income deduction to offset 20% of qualifying business income to individuals and trusts and estates for tax years beginning in 2018 through 2025. This deduction is discussed in further detail on Page 19.

**Individual Tax Rates**
As under prior tax law, there will continue to be seven ordinary income tax brackets. Starting in 2018, the marginal rates will be 10%, 12%, 22%, 24%, 32%, 35% and 37%.

Interestingly, the bracket for the lowest-income taxpayers remains unchanged while the 35% tax rate bracket begins at a lower threshold of $200,000 for single filers and $400,000 for married filing jointly. The maximum rate will kick in at a higher income threshold.

A comparison of the tax rates expected in 2018 under the old law compared with the Act’s new tax rates for married filing jointly and single filing status is summarized in the following table:

<table>
<thead>
<tr>
<th>Married Filing Jointly and Surviving Spouse</th>
<th>New Tax Rates</th>
<th>Amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Tax Rates*</td>
<td>Amounts</td>
<td>Amounts</td>
</tr>
<tr>
<td>10%</td>
<td>$0 - 19,050</td>
<td>10%</td>
</tr>
<tr>
<td>15%</td>
<td>$19,050 - 77,400</td>
<td>12%</td>
</tr>
<tr>
<td>25%</td>
<td>$77,400 - 156,150</td>
<td>22%</td>
</tr>
<tr>
<td>28%</td>
<td>$156,150 - 237,950</td>
<td>24%</td>
</tr>
<tr>
<td>33%</td>
<td>$237,950 - 424,950</td>
<td>32%</td>
</tr>
<tr>
<td>35%</td>
<td>$424,950 - 480,050</td>
<td>35%</td>
</tr>
<tr>
<td>39.6%</td>
<td>$480,050+</td>
<td>37%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Single</th>
<th>New Tax Rates</th>
<th>Amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Tax Rates*</td>
<td>Amounts</td>
<td>Amounts</td>
</tr>
<tr>
<td>10%</td>
<td>$0 - 9,525</td>
<td>10%</td>
</tr>
<tr>
<td>15%</td>
<td>$9,525 - 38,700</td>
<td>12%</td>
</tr>
<tr>
<td>25%</td>
<td>$38,700 - 93,700</td>
<td>22%</td>
</tr>
<tr>
<td>28%</td>
<td>$93,700 - 195,450</td>
<td>24%</td>
</tr>
<tr>
<td>33%</td>
<td>$195,450 - 424,950</td>
<td>32%</td>
</tr>
<tr>
<td>35%</td>
<td>$424,950 - 426,700</td>
<td>35%</td>
</tr>
<tr>
<td>39.6%</td>
<td>$426,700+</td>
<td>37%</td>
</tr>
</tbody>
</table>

* Current tax rates and brackets were the rates and brackets for 2018 as announced by the IRS prior to the Act.

**OUR THOUGHTS ON...**

**FEDERAL TAX WITHHOLDING**

Many individuals may begin to notice changes as early as February 2018 through reduced federal withholding on their earnings. The IRS has announced that it anticipates issuing new withholding guidelines in January and will be encouraging employers to implement the changes in February. The changes are necessitated by law changes such as the elimination of “personal exemptions” and increases in the standard deduction that are also used to calculate withholding on Forms W-4.
Starting in 2018, the new 37% tax rate will begin at the following taxable income thresholds:

- Married Filing Jointly: $600,000 of taxable income
- Qualifying Widow(er): $600,000 of taxable income
- Head of Household: $500,000 of taxable income
- Single: $500,000 of taxable income
- Married Filing Separately: $300,000 of taxable income

**Kiddie Tax**

Under the old law, if a child’s unearned income was more than $2,100, part of that income could be taxed at the parents’ tax rate instead of the child’s tax rate. In theory, the new law simplifies the calculation by applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child. However, the condensed tax brackets applicable to trusts and estates appear to apply the highest capital gain tax rate at lower income levels, resulting in higher taxes paid by the child under the new law.

**Marriage Penalty**

The “marriage penalty,” a concept in which some taxpayers may incur a higher tax liability if they utilize the married filing jointly filing status, has been mostly eliminated. The married filing jointly brackets’ amounts are double the single bracket except for the two highest brackets, where the marriage penalty begins to be felt at income levels exceeding $300,000.

**Capital Gain and Qualifying Dividend Tax Rates**

The Act generally retains the current tax rates for capital gain and qualified dividend income of 0%, 15% and 20%. For 2018, the special rates of 15% and 20% apply to taxpayers (married filing jointly) with taxable income exceeding $77,200 and $479,000, respectively.

**OUR THOUGHTS ON...**

**20% BUSINESS INCOME DEDUCTION AND NET INVESTMENT INCOME TAX**

The 20% business deduction available to individuals to reduce qualified business income may not reduce income subject to the net investment income tax.

(thresholds are cut in half for married filing separately). These income thresholds are indexed for inflation. Special maximum rates for unreaptured Section 1250 property (25%) and certain property such as collectibles, etc. (28%) remains unchanged.

**Net Investment Income Tax**

The net investment income (NII) tax rate remains at 3.8%. However, other tax law changes may impact the calculation of net investment income.

**Standard Deduction and Personal Exemptions**

The Act increases the standard deduction to the following amounts for 2018:

- $24,000 – Joint Return or a Surviving Spouse
- $18,000 – Unmarried individual with at least one qualifying child
- $12,000 – Single Filers

The additional standard deduction for the blind and the elderly is retained. This amount remains at $1,250 and doubles for a taxpayer both blind and elderly.

The Act suspends the deduction for personal and dependency exemptions for tax years beginning after December 31, 2017, and before January 1, 2026. This amount was expected to be $4,150 for 2018 (subject to phase-out).

Currently about 30% of filers, or 45 million, itemize their deductions. The new law is estimated to allow 20 million individual taxpayers to switch to the standard deduction. This may not be viewed by many to be a favorable aspect of the law. For example, under prior law, a non-itemizing married couple with two qualifying dependent children, would have been allowed a standard deduction of $13,000 and four individual exemptions totaling $16,600, for a combined deduction of $29,600. This is $5,600 greater than the new standard deduction allowed pursuant to the Act. However, the benefit...
obtained due to the change in rates, along with the ability to use new child and dependent credits (discussed below), may reduce the taxpayer’s tax liability.

**Alternative Minimum Tax**

Although the initial proposals sought to eliminate the alternative minimum tax (AMT), budget constraints resulted in a compromise that retains the AMT structure yet increases both the AMT exemption and phase-out amounts. The Act increases the AMT exemption amounts for individuals as follows:

- $109,400 for married taxpayers filing jointly or for surviving spouses (from $84,500 for 2017);
- $70,300 for single taxpayers (from $54,300 for 2017); and
- $54,700 for married taxpayers filing separately (from $42,250 for 2017).

The phase-out of the AMT exemption was increased as follows:

- $1,000,000 for married taxpayers filing jointly or for surviving spouses ($160,900 in 2017); and
- $500,000 for all other taxpayers ($120,700 for single taxpayers in 2017).

**Itemized Deductions**

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

**Mortgage Interest**

The Act does not allow a mortgage interest deduction with respect to interest paid on home equity indebtedness for tax years beginning after December 31, 2017 and before January 1, 2026. However, it retains the mortgage interest deduction for interest paid on acquisition indebtedness of up to $750,000 ($500,000 for a married person filing a separate return) for debt incurred after December 15, 2017, until reverting back to $1,000,000 after December 31, 2025, regardless of when the debt was incurred.

Interest on existing debt exceeding $750,000, but not more than $1,000,000, can continue to be deducted under “grandfather” provisions.

Existing mortgage debt that is refinanced may continue to be covered under grandfather provisions as long as the refinanced balance does not exceed the debt balance immediately prior to the refinancing.

While there was talk of disallowing interest deductions for second homes, that provision did not make it into the Act. The combined acquisition indebtedness on both homes is limited to a total of $750,000.

**Taxes (including real estate, state, local, and foreign income taxes)**

Under the Act, individuals are now limited to a combined total of $10,000 for state and local income taxes, state and local property taxes, and sales taxes.

The $10,000 limitation does not apply to real and personal property taxes if the taxes are incurred in a trade or business or incurred for the production of income.

Foreign real property taxes are not deductible unless directly related to a trade or business activity.

**Medical Expenses**

The floor on the deductibility of medical expenses has been reduced from 10% of adjusted gross income (AGI) to 7.5% of AGI. While the Act applies this change retroactively for 2017, it is only in effect for 2017 and 2018. After 2018, the floor will revert back to the 10% AGI floor.

**Moving Expenses and Employer-Provided Housing**

The moving expense deduction is suspended except for active duty members of the Armed Forces who move pursuant to a military order and incident to a permanent change of station. Employer-provided lodging remains excludible from the employee’s gross income, as long as the employee is required to accept the lodging on the business premises of the employer as a condition of employment.
The Act repeals the exclusion from income for qualified moving expense reimbursements for tax years beginning after January 1, 2018 and ending before January 1, 2026.

**Personal Casualty and Theft Losses**

The Act limits the deduction for personal casualty and theft losses to apply only to losses incurred as a result of federally declared disasters.

**Charitable Contributions**

The Act increases the AGI limitation on cash contributions to public charities from 50% to 60%. Cash contributions exceeding 60% of AGI will be allowed to be carried forward for five years.

Appreciated property contributions remain subject to the current AGI limitation of 30%.

Charitable contribution carryovers from years before 2018 will continue to be allowed subject to previously existing AGI percent limitations.

**OUR THOUGHTS ON...**

**CHARITABLE CONTRIBUTIONS**

As a result of changes to the standard and itemized deductions, the bottom line is that taxpayers with itemized deductions less than the standard deduction (e.g., $24,000 married filing jointly) will no longer receive as much tax savings benefit from making charitable donations. It may beneficial to time future donations so that every few years it is possible to exceed the higher standard deduction threshold and benefit from the charitable contribution deduction periodically.

"Donations" Involving University Athletic Seating Rights

Effective for contributions made in tax years beginning after 2017, the Act repeals the current 80% deduction for contributions made for university athletic seating rights.

**Alimony and Child Support**

Alimony and separate maintenance payments will no longer be deductible by the payor spouse and will no longer be includible in the income of the recipient spouse. This change is effective for any divorce or separation instrument executed after December 31, 2018, including modifications made after December 31, 2018, to a divorce or separation instrument that was executed on or before December 31, 2018. The treatment of child support has not changed; these payments remain nondeductible.

**Miscellaneous Itemized Deductions**

The Act suspends the ability to deduct all miscellaneous itemized deductions that were previously subject to the 2% floor, including unreimbursed employee expenses, the home office deduction and tax preparation fees.

For many individuals with significant portfolio income who incur management and investment fees to generate that income, these expenses will no longer be deductible. This includes a taxpayer’s share of investment expenses from a pass-through entity. The above changes will take effect for the tax years after December 31, 2017 and ending before January 1, 2026.

**Child and Dependent Tax Credit**

The Act increases the child tax credit to $2,000, up from $1,000. The credit, like its predecessor, is available for a qualifying child under the age of 17.

The credit is refundable up to a maximum of $1,400.

The Act also provides a new $500 nonrefundable credit for dependents other than qualifying children, such as older children or parents.

**OUR THOUGHTS ON...**

**CHILD AND DEPENDENT CREDITS**

The new credits may help to offset the cost associated with the elimination of the personal exemption for children and dependents. However, unlike the prior law that allowed personal exemptions for children, a taxpayer and his/her spouse, the new dependent credit is not applicable to taxpayers or their spouses.
The threshold amount where the credit would begin to phase out is increased to $400,000 for joint filing taxpayers (up from $110,000) and increased to $200,000 for single filers (up from $75,000). This threshold is not indexed for inflation.

The Act will require taxpayers to provide the social security number of each qualifying child who is claimed on the tax return. Other dependents of the taxpayer for whom the $500 nonrefundable credit is claimed do not require disclosure of their social security numbers.

**Education Expenses**

The Act provides that public, private or religious elementary and secondary school tuition expenses of up to $10,000 per year will be qualified expenses for Section 529 plans.

Accordingly, taxpayers will be able to use Section 529 plan assets to fund other than just post-secondary education expenses.

**Student Loan Indebtedness Debt Discharge**

The Act provides for an income exclusion for discharge of a loan if the discharge was pursuant to the death, or total and permanent disability, of a student. The provision applies to discharges of loans occurring after December 31, 2017 and before January 1, 2026.

**Achieving A Better Life Experience (ABLE) Program Enhancement**

ABLE accounts are a tax-favored savings vehicle established with the assistance of state, or agencies or instrumentalities of the state, and are used to encourage individuals and families to save funds to assist a disabled individual incurring qualified disability expenses.

The Act increases the contribution limit, which is tied to the federal gift tax exclusion amount, to ABLE accounts under certain circumstances. Once the overall limitation on contributions is reached, the designated beneficiary would be able to contribute an additional amount, up to the lesser of the federal poverty line for a one-person household, or the individual’s compensation for the tax year.

Taxpayers can roll over amounts from qualified tuition programs into ABLE accounts without penalty, but only if the designated beneficiary (or member of the beneficiary’s family) of the qualified tuition plan owns the ABLE account. Such amounts would count toward the overall limitation on contributions to an ABLE account within a tax year, and any amount in excess would be includible in the distributee’s gross income. This provision is effective upon enactment until after December 31, 2025.

**Gain from Sale of Residence**

The exclusion of gain realized on the sale or exchange of a principal residence remains unchanged from current law, which excludes up to $250,000 ($500,000 for married filing jointly).

**Miscellaneous Credits**

The Act made no changes to, and therefore preserves, the following popular tax credits:

- Earned Income Credit;
- American Opportunity Credit; and
- Adoption Credit.
The Act does not repeal the estate and generation-skipping transfer (GST) taxes. However, the Act does reduce the number of individuals impacted by those taxes and makes less significant changes to taxation of estates, gifts and trusts.

**Trust and Estate Income Tax Rates**

Unlike the seven individual income tax brackets, the number of income tax brackets for estates and trusts has been reduced to four (10%, 24%, 35%, 37%) from the five that existed under prior law. The size of the brackets has generally remained the same except for the 24% bracket, which combines two of the brackets that existed under previous law (see table below).

For the 2018 through 2025 tax years, the trust and estate income tax brackets have been modified as follows:

<table>
<thead>
<tr>
<th>Taxable Income starting at</th>
<th>But not over</th>
<th>2017 Tax Rate</th>
<th>2018 Tax Rate (under the Act)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>$2,550</td>
<td>15%</td>
<td>10%</td>
</tr>
<tr>
<td>$2,550</td>
<td>$6,000</td>
<td>25%</td>
<td>24%</td>
</tr>
<tr>
<td>$6,000</td>
<td>$9,150</td>
<td>28%</td>
<td>24%</td>
</tr>
<tr>
<td>$9,150</td>
<td>$12,500</td>
<td>33%</td>
<td>35%</td>
</tr>
<tr>
<td>$12,500</td>
<td>no cap</td>
<td>39.6%</td>
<td>37%</td>
</tr>
</tbody>
</table>

**Estate Taxes**

Under prior law, an individual could transfer, during life or at death, an amount equal to $5 million (the Exemption) before the transfer would be subject to a 40% estate or gift tax. Under the Act, for transfers occurring after December 31, 2017, the Exemption (as well as the GST tax exemption) has been increased to $10 million per individual and indexed for inflation using 2011 as the base year. Beginning in 2018, an individual would need to transfer, during life and at death, assets in excess of $10 million (adjusted for inflation) before the 40% federal estate or gift tax would apply. For married couples, the amount is effectively increased to $20 million (adjusted for inflation).

The increase of the Exemption is effective only for those transfers that occur between January 1, 2018 and December 31, 2025. On January 1, 2026, the Exemption returns to the pre-Act level of $5 million (adjusted for inflation).

**Asset Gifting**

The annual gift exclusion, which allows taxpayers to transfer a “de minimis” amount per year, per donee, was not modified by the Act. For 2018, the annual exclusion is $15,000 per person, per donee.

**Basis of Inherited Property**

The rules regarding establishing basis in inherited property have not changed. Therefore, the beneficiary of inherited property will continue to receive a basis adjustment equal to the fair market value of the inherited property on the decedent’s date of death.
OUR THOUGHTS ON...

ESTATE AND GIFT PLANNING STRATEGIES

The Act did not directly restrict or broaden popular tools in an estate planner’s tool kit such as (i) grantor-retained annuity trusts, (ii) charitable bequests, (iii) valuation discounts, (iv) marital deductions, or (v) grantor trusts that are excludable from an individual’s gross estate for estate tax purposes.

Miscellaneous

A summary of other changes include:

• The class of beneficiaries that qualifies under the Electing Small Business Trust (ESBT) rules has been expanded to include nonresident aliens. (Note: An ESBT is a trust that owns “S” corporation stock which is required to make a qualifying election so as to not terminate the “S” election made by the entity.)

• The charitable deduction of an ESBT will no longer be determined by rules applicable to trusts (generally, dollar-for-dollar deductions), but will now be governed by the charitable deduction rules as applicable to individuals (subject to annual income limitations, carryforward rules, etc.)

• The alternative minimum tax (AMT) as applied to trusts remains unchanged under the Act. This is notable considering the Act repealed the corporate AMT and increased the exemptions for the individual AMT.
General Impact on Tax-Exempt Organizations

The Act includes a number of changes that impact tax-exempt organizations. Fortunately, provisions causing some consternation back in November when the House issued the first draft of the proposed bill did not make it into the final version.

In addition to changes directly impacting exempt organizations, there are also a number of individual tax provisions that indirectly impact tax-exempts; a few of the most notable include repeal of the charitable deduction for college athletic ticket seating rights, suspension of the exclusion for qualified moving expense reimbursement, and changes to the education savings rules. For further information, please refer to the Individual tax section of this booklet.

Separation of Trade or Business Activities Under Unrelated Business Income Rules

Under current law, an organization that operates multiple unrelated trades or businesses aggregates revenue and deductions related to the activity. The Act now requires an organization with more than one unrelated trade or business activity to compute its net unrelated business income on a separate trade or business basis and without regard to the specific deduction generally allowed under Internal Revenue Code (IRC) §512(b)(12). That is, an organization may no longer use a deduction from one trade or business to offset income from a different unrelated trade or business. Rather, an organization's net unrelated business income for the taxable year is generally the sum of the amounts (not less than zero) computed for each separate unrelated trade of business.

Going forward, a net operating loss deduction is allowed only with respect to a trade or business from which the loss arose. However, the amendment generally does not prevent an organization from using a deduction from one taxable year to offset income from the same unrelated trade or business activity in another taxable year. The amendment to IRC §512 is effective for taxable years beginning after December 31, 2017. Under a special transition rule, net operating losses arising in a taxable year beginning before January 1, 2018, may be carried forward to a taxable year beginning on or after such date.

Certain Fringe Benefits Treated as Unrelated Business Taxable Income (UBTI)

The Act provides that certain nontaxable fringe benefits provided by an exempt organization to its employees are now taxable as UBTI. These benefits include qualified transportation fringe benefits (parking and/or transit passes) and/or the use of an on-premises athletic facility provided to its employees (i.e., workout facilities). The rule does not apply to the extent the amount paid or incurred is directly connected with an unrelated trade or business, or if the exempt employer treats such fringe benefits as taxable compensation. The amendment will apply to amounts paid or incurred after December 31, 2017.

Corporate Provisions Impacting Tax-Exempt Organizations

Several provisions of the Act that are applicable to corporations will also apply to tax-exempt organizations organized as nonprofit corporations. These include changes to the corporate tax rates, repeal of the corporate alternative minimum tax, refund of minimum tax credits and the limitation on the use of net operating losses. In addition, other business provisions, such as the changes to bonus depreciation and the Section 179 deduction may apply. For further explanation of these provisions, see the Business section starting on Page 19.

Excise Tax on Tax-Exempt Organization Executive Compensation

The Act added a provision that addresses tax-exempt organizations and the highly compensated individuals they employ. The new law provides that a tax-exempt employer is liable for an excise tax equal to 21% of the sum of any remuneration in excess of $1 million paid to a covered employee by the organization for the taxable year.
The term “remuneration” generally means wages, except that such term shall not include any designated Roth contribution. Remuneration also includes any compensation paid by a related person or governmental entity.

Excluded from this excise tax is any remuneration paid to a licensed medical professional to the extent payment is for performance of medical or veterinary services. Medical professionals for this purpose include doctors, nurses and veterinarians.

A “covered employee” is an employee (including former employees) of a tax-exempt organization if the employee is one of the five highest-compensated employees of the organization for the taxable year or was a covered employee of the organization (or a predecessor) for any preceding taxable year beginning after December 31, 2016.

The 21% excise tax also applies to any parachute payment that exceeds the portion of the base amount allocated to the payment. The term “base amount” is defined as the average annual compensation of the employee for the five tax years before the employee’s separation from employment.

This provision is effective for tax years beginning after December 31, 2017.

For purposes of determining whether an institution meets the asset-per-student threshold, and to determine the amount of net investment income, assets and net investment income of related organizations are included. An organization is treated as related to the institution for this purpose if the organization: (1) controls, or is controlled by, the institution; (2) is controlled by one or more persons who control the institution; or (3) is a supported organization or a supporting organization during the taxable year with respect to the institution.

The provision is effective for taxable years beginning after December 31, 2017.

Tax-Exempt Bonds

Tax-exempt organizations, amongst other bond issuers, will sometimes utilize a financing vehicle known as a refunding bond to lower interest payments when interest rates dip below a currently issued bond’s interest rate. The refunding bond pays off the existing bond obligation with the new capital and lowers the interest rate.

Generally, there are two types of tax-exempt bonds: (1) government bonds and (2) private activity bonds. Government bonds typically fund government functions or are repaid with government funds. Interest paid on these bonds is generally excluded from gross income. Conversely, a private activity bond provides pass-through financing to nongovernmental entities via a state or local
government. Interest paid on private activity bonds is only excludable from a taxpayer’s income if the bond is deemed “qualified.”

The Act eliminates this exclusion from gross income for advance refunding of qualified private activity bonds and makes interest generated by a refunding bond taxable. To qualify as an advance refunding bond, the refunding bond must be issued more than 90 days before the redemption of the old bond. Taxing the interest generated from these bonds ultimately makes the refunded bonds less attractive to investors and forces tax-exempt bond issuers to compete with other bond-issuing organizations. This provision is effective for advance refunding bonds issued after December 31, 2017.

Contemporaneous Written Acknowledgments

Generally, IRC §170 provided for an exception to the contemporaneous written acknowledgment requirement for contributions of $250 or more if the donee organization filed a return in accordance with regulations prescribed by the Secretary of the U.S. Treasury. No final regulations were issued. The Act amended IRC § 170 to repeal the exception effective for contributions made in tax years beginning after December 31, 2016.

**OUR THOUGHTS ON... MOVING FORWARD FOR TAX-EXEMPTS**

- Focus on efforts to retain donation revenue stream.
- Unrelated business income:
  - Consider the impact of separately stated businesses, NOL limitations and rate changes.
  - Monitor additional guidance provided by the IRS on the calculation of unrelated business income.
  - Diligently track and document expenses in connection with unrelated business activities.
- Review international investments and operations to determine the impact of tax reform.
- Consider the impact of tax reform on financial reporting.
- Determine how your organization will treat certain employee benefits that could result in unrelated business income.
The Act includes changes impacting compensation, treatment of fringe benefits, and operational rules for IRAs and qualified retirement plans.

Recharacterization of Certain IRA and Roth IRA Contributions

Taxpayers may elect to convert funds accumulated in a traditional, pre-tax Individual Retirement Account (IRA) to a Roth IRA. This election, known as a “recharacterization,” results in the taxation of the entire IRA account balance in the year of conversion and allows future earnings to be accumulated and distributed on a tax-free basis.

Previous tax rules allowed individuals to reverse an IRA recharacterization no later than October 15 following the year in which the election was originally made. The rule provided taxpayers with an important option in instances where the value of the IRA declined significantly after the conversion. Effective for tax years beginning after December 31, 2017, the reversal of an election to recharacterize a Roth conversion will no longer be permitted.

Expanded Rules Limiting Deductions for Excessive Employee Compensation

Prior to the Act changes, the deduction for compensation paid to a CEO and the three highest-paid officers of a public company (“covered employees”) was limited to $1,000,000 per covered employee per tax year. Due to an oversight in the law, the CFO was not considered a “covered employee.” In addition, prior law contained significant exemptions, including a much-used exemption for performance-based compensation, which eviscerated the general rule.

The exemption for qualified performance-based compensation has been eliminated under the new law for tax years beginning in 2018. This is a major change, because for many public companies, performance-based compensation constituted the majority of senior executive pay. An important transition rule was included in the final legislation that provides that the changes will not apply to compensation payable under a written binding contract in effect on November 2, 2017. Many questions remain regarding the scope and application of this transition rule; thus, future IRS guidance is expected. Caution is advised when considering modification of existing plans and agreements.

The Act revises the definition of “covered employee” to include the CEO, CFO and the next three highest compensated officers. The definition of compensation has been expanded to include compensation paid after termination of employment (such as severance, non-qualified pension benefits and other compensation deferred beyond separation from service). Once a covered employee, the individual retains this standing post-employment such that payments to an estate...
or beneficiary would be subject to the deduction limitations.

OUR THOUGHTS ON...
EXECUTIVE COMPENSATION LIMITATIONS
Section 162(m) has also been expanded to apply to companies with publicly traded debt and foreign companies with publicly traded ADRs. More ominously, the Conference Committee report indicates the provision may apply to large private “C” or “S” corporations.

Length of Service Awards for Public Safety Volunteers

Prior to the Act, a plan that only provides length of service awards to bona fide public safety volunteers or their beneficiaries, on account of qualified services performed by the volunteers, was not treated as a plan of deferred compensation, provided that the aggregate amount of awards accruing for a bona fide volunteer does not exceed $3,000.

For tax years beginning after December 31, 2017, the new tax law increases the aggregate amount of length of service awards that may accrue from $3,000 to $6,000. That amount may be increased in future years for inflationary adjustments.

Non-Tangible Personal Property Definition Expanded Regarding Deductible Employee Achievement Awards

The new law clarifies the definition of “tangible personal property” in the context of deductible employee achievement awards. The term specifically excludes and denies deductibility for awards of cash, cash equivalents, gift coupons, or gift certificates as well as vacations, meals, lodging, or tickets to theater or sporting events, stocks, bonds securities or other similar gifts paid or incurred.

Congress appears to have been concerned that employers were being overly zealous in the interpretation of tangible personal property excludable from an employee’s income.

Qualified Equity Grant Changes

The Act provides an opportunity for private company employees to participate in value creation outside of a liquidity event. Under this provision, companies can issue qualified equity grants that permit the employees to defer taxation on vested restricted stock units or stock options for up to five years.

To qualify, the plan must encompass at least 80% of all full-time U.S. employees and deliver the same rights and privileges, but not necessarily the same amount of shares. Certain senior employees, including owners and highly compensated officers, are ineligible to receive this benefit.

As with other deferred compensation plans, the compliance rules can be both onerous and complex.

Rollover of Plan Loan Offsets

Effective for tax years beginning after December 31, 2017, in order to avoid taxation on the balance of a plan loan, participants in qualified retirement plans who receive a taxable distribution following a severance from employment or whose plan terminates, may, not later than the due date of their individual income tax return, contribute the balance of the outstanding plan loan to an Individual Retirement Account (IRA).

Entertainment, Meals and Transportation

Acknowledging that a discussion on business entertainment and meals may be better suited in the Business section, for tax years after December 31, 2017, no deduction is allowed for business entertainment, amusement or recreation expenses. This provision applies to expenses incurred during the active conduct of the taxpayer’s trade or business, including business meetings at a convention. Club dues continue to be nondeductible.

The deduction for 50% of food and beverage expenses incurred by company employees while on company business continues to be deductible under the law.

The deduction for meals provided for the convenience of the employer will be eliminated. This includes employer-operated eating facilities formerly considered a “de minimis” fringe benefit. The effective date for eliminating deductions for the meals paid for the
convenience of the employer applies to amounts paid after December 31, 2025.

Effective after December 31, 2017, no deduction will be allowed to an employer for the payment or reimbursement of employee transportation expenses that are treated as a qualified transportation fringe benefit, including bicycle commuting reimbursements, for travel between their residence and place of employment. An exception is available for amounts paid to ensure the safety of an employee.

**Qualified Plan Distribution Special Disaster Relief for 2016 Disaster Victims**

Prior to the Act, distributions from eligible retirement plans were included in income in the year distributed. Additionally, if the distribution was prior to an individual attaining age 59-1/2, a 10% early withdrawal penalty tax would generally apply.

The new tax law provides special relief for individuals residing in areas declared by the President as a Disaster Area under Section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act during calendar year 2016. To the extent an individual in a declared disaster area took a distribution from an eligible retirement plan between January 1, 2016 and December 31, 2017, the distribution may be eligible to be excluded from the 10% early withdrawal penalty tax.
Corporate Changes – Rate Reduction, AMT, Dividends Received Deduction

The Act establishes a flat corporate income tax rate of 21% for tax years beginning after December 31, 2017, replacing current rates that range from 15% to 35%. The Act also eliminates the special tax rate on personal service corporations (PSC). Accordingly, PSCs, like other corporations, will now be taxed at the flat 21% rate.

The Act eliminates the corporate AMT. However, existing AMT credit carryovers will continue to provide benefits. Corporations with AMT credit carryovers will be able to use income credits to (i) reduce or eliminate regular tax liability, and (ii) obtain tax refunds to the extent the AMT credit carryovers exceed regular income tax liability. For tax years beginning in 2018, 2019 and 2020, 50% of the excess AMT credit carryovers are refundable to the extent that AMT credit carryovers exceed regular tax liability (with limitations). Any remaining AMT credits will be fully refundable in 2021.

The new law lowers the dividends received deduction (DRD) from 80% to 65% for dividends received from 20% or greater owned subsidiary corporations. For dividends received from corporations in instances when the taxpayer’s ownership is less than 20%, the DRD will be 50% (down from 70%).

Our Thoughts on...

Corporate Tax Reform

Congress believes that the corporate tax rate reduction was necessary to remain competitive in the global economy. The change in the “C” corporation tax rate may cause taxpayers to reconsider their choice of entity designations.

Limitations in Utilization of Net Operating Losses

Net operating loss (NOL) deductions will now be limited to 80% of taxable income, effective with respect to losses arising in tax years beginning after December 31, 2017. This limitation is similar to, although more restrictive than, the current 90% limitation for NOLs in the now repealed corporate AMT regime.

The Act eliminates, except for certain farming losses and property and casualty insurance companies, the ability to carry back net operating losses. However, the 20-year NOL carryforward period has been eliminated. NOLs arising in tax years beginning after December 31, 2017 can now be carried forward indefinitely.

Pass-Through Business Income Deduction

The Act provides new preferential treatment of business income from pass-through entities (e.g., “S” corporations, partnerships, limited liability companies, and sole proprietorships) by creating a new income tax deduction. Individual taxpayers (along with trusts and estates) are permitted to deduct 20% of pass-through qualified business income (QBI) as a deduction from their taxable income. The deduction will be claimed as a deduction against business taxable income, not the...
The Act will limit the amount of “excess business losses” a non-corporate taxpayer may claim in a given tax year. This provision is set to take effect for tax years beginning after December 31, 2017 and beginning before January 1, 2026.

The Act defines an “excess business loss” as the excess of the taxpayer’s aggregate trade or business deductions over the sum of 1) the taxpayer’s gross trade or business income, plus 2) a threshold amount of $250,000 ($500,000 for joint filers). The threshold amount will be indexed for inflation. The Act permits taxpayers to carry forward any excess business losses into future tax years as net operating losses (subject to the 80% annual NOL income limitation).

The excess business losses limitation should be taken into account after the application of passive activity loss, at-risk loss rules and related credit limitations. Partnership and “S” corporation business loss limitations are applied at the partner and shareholder level.

**OUR THOUGHTS ON...**

**EXCESS BUSINESS LOSS LIMITATION**
This limitation will cause continued deferral of suspended passive activity losses for taxpayers with losses exceeding the loss ceiling for at least one year and possibly more due to the NOL deductibility limitation of 80%.

**Like-Kind Exchanges**

Under previous law, nonrecognition of gain applies to like-kind exchanges of (1) depreciable tangible personal property; (2) intangible or nondepreciable personal property; and (3) real property. After December 31, 2017, like-kind exchanges will only be allowed for exchanges of real property not primarily held for sale.

Exchanges of personal property, most often automotive equipment, will no longer qualify for like-kind exchange treatment; those exchanges will now result in taxable gain or loss.
Sale of a Partnership Interest by Foreign Persons

Under the Act, gain or loss from the sale of a partnership interest is to be treated as effectively connected with a U.S. trade or business to the extent that the transferor would have had effectively connected income (ECI) if the partnership had sold all of its assets at fair market value. This is effective for sales or exchanges occurring on or after November 27, 2017.

The provision also requires the transferee of an interest to withhold 10% of the amount realized unless the transferor certifies that the transferor is not a nonresident alien individual or foreign corporation. The withholding provision is effective for sales occurring after December 31, 2017.

Definition of “Substantial Built-In Loss” for Transfers under IRC Section 743

The Act expands the definition of “substantial built-in loss” relative to sales or exchanges of partnership interests. Prior to the modification, a substantial built-in loss existed only if the partnership’s aggregate adjusted basis in its property exceeded the fair market value of the property by more than $250,000.

Under the provision, a substantial built-in loss will also exist if the transferee partner would, upon a hypothetical liquidation of partnership assets for fair market value, be allocated a net loss in excess of $250,000. As a result, test for a substantial built-in loss now applies at both the partnership level and at the transferee partner level. The provision applies to transfers of partnership interests after December 31, 2017.

Partnership Loss-Disallowance Rule Modification

As the Joint Conference Committee noted, “the provision modifies the basis limitation on partner losses to provide that the limitation must account for a partner’s distributive share of partnership charitable contributions and foreign taxes paid or accrued. Thus, the amount of the basis limitation on partner losses is decreased to reflect these items. In the case of a charitable contribution by the partnership, the amount of the basis limitation on partner losses is decreased by the partner’s distributive share of the adjusted basis of the contributed property.”

For gifts of appreciated property (fair value in excess of basis), a special rule provides that the basis limitation on partner losses does not apply to the extent of the partner’s distributive share of the appreciation. The provision applies to partnership taxable years beginning after December 31, 2017.

OUR THOUGHTS ON...

PERSONAL PROPERTY LIKE-KIND EXCHANGES
Note that the immediate write-off available for investment in property should minimize the current impact of personal property no longer qualifying for like-kind exchange treatment.

OUR THOUGHTS ON...

FOREIGN-OWNED PARTNERSHIP INTEREST
This provision may be in response to the recent Tax Court ruling in Grecian Magnesite v. Commissioner. In ruling for the taxpayer, the Court invalidated a long-standing IRS position that sales of partnership interests were to be treated as ECI by foreign persons. The new rule essentially adopts the IRS position into law.

OUR THOUGHTS ON...

SUBSTANTIAL BUILT-IN LOSSES
The expanded definition of substantial built-in loss is intended to address situations where a partnership may not have an overall built-in loss on its properties in the aggregate, but due to special allocation provisions, a partner may have a built-in loss with respect to their interest.

OUR THOUGHTS ON...

PARTNERSHIP LOSS DISALLOWANCE RULE
This provision corrects a technical flaw in the Section 704 regulations, which omit these two items from the basis calculation for purposes of the loss-disallowance rule. The provision brings the partnership loss-disallowance calculation into alignment with the loss-disallowance calculation for “S” corporations.
Repeal of Technical-Termination Rule for Partnerships

The Act repeals the “technical-termination” rule of IRC Section 708(b)(1)(B). Thus, a partnership will only be considered terminated if no part of the partnership business is carried on by any of its partners. This provision is effective for taxable years beginning after December 31, 2017.

Our Thoughts on...

NEW TECHNICAL TERMINATION RULE
This is generally welcome news for partnerships and their tax preparers. Under the technical-termination rule, the partnership’s year would close upon sale or transfer of a 50% or more interest in the partnership, creating a short-period filing requirement for the terminated partnership. It also required the partnership to re-start depreciation (over the full recovery period) as if the depreciable property has been newly acquired. Repeal of the technical-termination rule eliminates needless complexity and administrative burdens.

Conversions from an “S” to a “C” Corporation

Certain “C” corporations that have converted from an “S” corporation during a two-year period beginning December 22, 2017 will take any Code Section 481(a) adjustment resulting from the conversion (e.g., due to an accounting method change) into income over six years. In addition, if an eligible terminated “S” corporation makes distributions after the post-termination transition period, the accumulated adjustments account will be allocated proportionally to such distribution as to earning and profits.

Our Thoughts on...

SMALLER BUSINESS ACCOUNTING METHODS
A new single gross receipts test will determine whether a small taxpayer may use simplified methods of accounting for tax purposes. As a result, many additional “C” corporations and partnerships with corporate partners will qualify for the cash method of accounting. However, those entities classified as tax shelters will not be eligible.

Accounting Methods Changes

Cash Method of Accounting

Under the cash receipts and disbursements method of accounting (cash method), a taxpayer typically includes an item of income in its gross income when cash is actually or constructively received. As a result, a taxpayer may defer the recognition of income on its accounts receivable until cash is collected. Similarly, taxpayers on a cash basis must delay the deduction for accounts payable and other liabilities until they are paid. There are eligibility restrictions associated with a taxpayer’s ability to use the cash method.

Historically, most “C” corporations and partnerships that have a “C” corporation as a partner, have not been permitted to use the cash method of accounting, with certain exceptions, including if the purchase, production or sale of merchandise was an income-producing factor.

The Act now permits most taxpayers with less than $25 million in average annual gross receipts (prior three years) to use the cash method regardless of whether the purchase, production or sale of merchandise is an income-producing factor.

Inventories

Under present law, taxpayers are generally required to account for inventory when the production, purchase or sale of merchandise is an income-producing factor. Further, taxpayers required to account for inventories generally must use the accrual basis method of accounting. There were exceptions for taxpayers with less than $1 million in average annual gross receipts and taxpayers with less than $10 million in average annual gross receipts that were otherwise eligible to use the cash basis method of accounting.

To simplify the recordkeeping for small businesses, businesses with less than $25 million in average gross receipts over the most recent three-year period are not required to maintain inventory. As a result, taxpayers can account for their inventories as non-incidental materials and supplies (which may be expensed by using the de minimis Safe Harbor Election) or by conforming to the treatment of inventories for financial statement purposes.
Uniform Capitalization Method of Accounting for Inventories

The requirement for taxpayers to capitalize indirect and overhead costs into inventory (known as Uniform Capitalization or UNICAP) has historically been required for all producers and for resellers and distributors with average gross receipts in excess of $10 million. The capitalization of these overhead costs creates a greater inventory value for tax purposes than for GAAP purposes and is a burdensome calculation for small businesses.

Under the Act, taxpayers are not required to comply with the UNICAP rules until average gross receipts during the most recent three-year period exceeds $25 million.

Completed Contract Method of Accounting

For income tax purposes, contractors are typically required to maintain their books and records on the percentage-of-completion method, whereby taxpayers include in gross income each year the portion of the total contract price that corresponds to the percentage of the contract that was completed during the year. This requirement had historically been waived for contractors whose average annual gross receipts for the three prior tax years did not exceed $10 million.

Under the Act, contractors are not required to use the percentage-of-completion method if their average annual gross receipts are less than $25 million. An additional requirement is that a contract must be expected to be completed within two years from the date of commencement of the contract. These provisions are effective for tax years beginning after December 31, 2017.

Deferrals of Income for Advance Payments

Under the general tax rules, accrual method taxpayers include an item of income in gross income in the year when all events have occurred that fix the right to receive the income and the amount can be determined with reasonable accuracy. For tax purposes, this means an item of income is includible in gross income at the earliest time that payment is received, when the income is due, when the amount is earned or when title passes. Taxpayers paid in advance for goods or services report income upon receipt of payment.

The Act modifies these rules. Now, accrual method taxpayers can generally follow two rules. Under the first, taxpayers can generally include advance payments in income no later than when the amounts are included for financial accounting purposes. Under the second rule and subject to limitations, accrual method taxpayers can elect to defer income associated with certain advance payments until the tax year after the tax year in which the payments were received.

Depreciation and Cost Recovery

The Act modifies the first-year expensing pursuant to Internal Revenue Code Section 179 and the Section 168(k) bonus depreciation allowance to provide taxpayers the ability to realize immediate tax benefits resulting from capital investments in their business.

Section 179 Expensing

The Act increases the Section 179 expensing limit to $1 million dollars (up from $500,000 currently). Similarly, the Act increases the Section 179 phase-out to $2.5 million dollars ($2 million currently). Both of these amounts are indexed for inflation beginning after 2018. The sport utility vehicle expensing limitation remains at $25,000.

The definition of qualified real property eligible for Section 179 expensing was expanded to include qualified improvement property (defined later) and certain improvements made to nonresidential real property (including roofs, heating, ventilation, air conditioning, fire protection and alarm systems, and other related property).
security systems); providing that the improvements were made after the date the property was first placed in service.

**Bonus Depreciation**

The Act modifies the existing bonus depreciation rules by increasing the first-year depreciation deduction to equal 100% of the basis of qualified property placed in service between September 28, 2017 and December 31, 2022. Thereafter, the amount of bonus depreciation is reduced by 20% annually, until fully phased-out by 2027. Qualified property with longer production periods follows a similar schedule. For both types of qualified property, taxpayers can alternatively elect to use 50% bonus depreciation (rather than 100% bonus depreciation) for the period September 28, 2017 through the first tax year ending after September 27, 2017. Additionally, the provision requiring that the original use of the property commence with the taxpayer has been removed. Accordingly, both new and used property are now eligible for bonus depreciation.

The following tables summarize the bonus depreciation thresholds as they relate to general qualified property and longer production period property and aircraft.

<table>
<thead>
<tr>
<th>Property Placed In Service</th>
<th>Bonus Depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td>September 28, 2017 through December 31, 2022</td>
<td>100%</td>
</tr>
<tr>
<td>During 2023</td>
<td>80%</td>
</tr>
<tr>
<td>During 2024</td>
<td>60%</td>
</tr>
<tr>
<td>During 2025</td>
<td>40%</td>
</tr>
<tr>
<td>During 2026</td>
<td>20%</td>
</tr>
</tbody>
</table>

<table>
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</tr>
<tr>
<td>During 2026</td>
<td>40%</td>
</tr>
<tr>
<td>During 2027</td>
<td>20%</td>
</tr>
</tbody>
</table>

The Act expands the definition of qualified property to include property used in qualified film, television and live theatrical production. Likewise, the Act excludes from the definition (1) certain public utility property and (2) property used in a trade or business that had floor plan financing indebtedness (i.e., retailer debt used to purchase vehicles where the debt is secured by the vehicle), unless the taxpayer with such trade or business is not a tax shelter prohibited from using the cash basis method of accounting and is exempt from the interest expense deduction limitation rules due to the $25 million gross receipts test for small businesses.

**Listed Property/Passenger Automobiles Depreciation**

The Act increases the depreciation limits for passenger automobiles and personal use property and also excludes computers and peripheral equipment from the definition of listed property.

<table>
<thead>
<tr>
<th>Passenger Automobiles Placed in Service After December 31, 2017</th>
<th>Maximum Depreciation Allowable Annually</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>$10,000</td>
</tr>
<tr>
<td>Year 2</td>
<td>$16,000</td>
</tr>
<tr>
<td>Year 3</td>
<td>$9,600</td>
</tr>
<tr>
<td>Year 4 and Later</td>
<td>$5,760</td>
</tr>
</tbody>
</table>

**Qualified Improvement Property Depreciation**

An error in drafting language of the Act caused an omission in the text that would have given a 15-year depreciation life for qualified improvement property.

Qualified improvement property is to include qualified leasehold improvement property, qualified restaurant...
property and qualified retail improvement property. In general, these improvements include those to the interior portion of a building that is nonresidential real property and does not include any enlargement of the existing structure, improvements to the exterior portion of the building or changes to the internal structural framework of a building.

A consequence of the error is that the above property does not qualify for bonus depreciation and will need to be treated as nonresidential real property with a depreciable life of 39 years.

A technical correction will need to be passed to create a 15-year recovery period for qualified improvement property.

Real Estate Depreciation

Although proposed, there were no substantive changes to the depreciable lives of nonresidential real or residential property. A real property trade or business may be required to use longer alternative depreciation system (ADS) lives if it is facing new business interest deductibility limitations.

Deductions for Domestic Production Activities (DPAD)

Effective for tax years beginning after December 31, 2017, DPAD will be repealed. Taxpayers previously taking advantage of DPAD received a deduction equal to 9% (6% in the case of certain oil and gas activities) of the lesser of qualified production activities income or taxable income. Taxpayers manufacturing in the United States and currently taking advantage of DPAD should consider the impact of the repeal in conjunction with the statutory rate reduction to determine the impact on cash taxes paid and effective tax rates.

Deductibility of Fines and Penalties for Federal Income Tax Purposes

Under current tax law, no deduction is allowed for fines or penalties paid to a government for the violation of any law. Under the Act, if a taxpayer is able to establish that a fine or penalty is associated with certain outlined exceptions, a deduction may now be available. Amounts paid for restitution, remediation, or amounts required to come into compliance with any law would now be deductible.

The outlined exceptions apply only in situations where a governmental agency is a party. Fines and penalties associated with past-due tax balances generally remain nondeductible.

Government agencies will be required to report to the IRS (and to the taxpayer) the amount of each settlement agreement in excess of $599 (consistent with 1099-MISC reporting rules). The report must identify any amounts that are paid in connection with restitution or for a correction of noncompliance.

This provision is effective for amounts paid or incurred on or after December 22, 2017.

OUR THOUGHTS ON...

PLANNING OF FINES AND PENALTIES

Existing law was clarified to provide some exceptions to the nondeductibility of fines and penalties. Settlement agreements with governments or their agencies should reflect amounts paid are for restitution, remediation, or for coming into compliance with law.

Denial of Deduction for Settlements Subject to Nondisclosure Agreement Paid in Connection with Sexual Harassment or Abuse

The Act introduces new deductibility rules applicable to expenses, including legal fees, with the settlement of a lawsuit that involves sexual harassment or abuse claims. Settlement payments subject to a nondisclosure agreement are no longer deductible. The tax impact of nondisclosure will now need to be taken into consideration when entering into nondisclosure agreements.

This provision will be effective for amounts paid or incurred on or after December 22, 2017.

Local Lobbying Expenses

Prior law generally disallowed a deduction for expenses incurred in connection with lobbying activities but provided an exception for amounts paid or incurred in connection with any legislation of any local council or similar governing body. The Act repealed the exception for amounts paid to lobby local councils and similar governing bodies effective for amounts incurred after December 22, 2017. All lobbying-related expenses are generally nondeductible post-enactment.
Carried Interest

The term “carried interest,” most commonly used in the private equity and hedge fund industries, relates, in part, to the way private equity and hedge fund managers are compensated for managing the funds. Many private equity and hedge funds use a 2/20 arrangement (or something similar) in which they charge their investors a 2% fee based on the value of the assets under management (ordinary income) and a 20% share in the profits received upon liquidation of the assets (capital gain). This 20% share represents the carried interest, which has been the source of much scrutiny and debate in the tax world for many years.

Under current law, proceeds from the sale of an interest in partnership profits are taxed at favorable capital gain rates, provided that the partnership interest is held for more than one year. The Act imposes a new three-year holding period requirement to obtain preferential long-term capital gain treatment. The Act treats the amount of an individual taxpayer’s net long-term capital gain with respect to an “applicable partnership interest” as short-term capital gain subject to ordinary income tax rates if the interest is not held for more than three years.

An applicable partnership interest is defined as any partnership interest that is transferred to or held by the taxpayer in connection with the performance of services (e.g., a profits interest) in an “applicable trade or business.” It does not include an interest in the capital of the partnership.

An applicable trade or business is any activity that involves the raising of capital and investing in or developing “specified assets,” which include:

- securities;
- commodities;
- real estate held for rental or investment;
- cash or cash equivalents; and
- options and derivatives with respect to any of the above.

Limitation on Business Interest Expense Deduction

The Act places a limit on the deductibility of business interest incurred by a business to the sum of business interest income, 30% of the business’s “adjusted taxable income,” and “floor plan financing interest.” This new provision (like the 20% qualified business income) appears to be more complicated in practice than initially thought, and applies equally to sole proprietorships and multinational corporations.

A business’s “adjusted taxable income” is a taxpayer’s taxable income plus:

- any item of income, gain, deduction or loss that is not properly allocable to the trade or business;
- any business interest or business interest income;
- any net operating loss deduction;
- the new 20% deduction for qualified business income of a pass-through entity; and
- for tax years beginning after January 1, 2018 and ending before January 1, 2022, its allowable deductions, depreciation, amortization and/or depletion deductions.

“Floor plan financing interest” means interest paid or accrued on floor plan financing indebtedness. Floor plan financing indebtedness means indebtedness used to finance the acquisition of a motor vehicle held for sale or lease to retail customers and secured by the inventory so acquired. A motor vehicle includes an automobile, truck, recreational vehicle, motorcycle, boat, and farm machinery and equipment.

The Act provides an exception to the limitation for any business that meets a $25 million gross receipts test. If the average annual gross receipts for the three prior years do not exceed $25 million, the interest expense deduction will not be limited.

A real property trade on business may elect out of the interest limitation rules at a slight cost of longer ADS depreciable lives on real property.

Business interest not allowed as a deduction in a tax year is carried forward indefinitely. However, excess business interest of a partnership or “S” corporation
does not remain at the entity level. Rather, it is passed through to each partner or shareholder. This treatment will complicate calculations of deductible interest in future years at the partner or shareholder level by requiring separate excess taxable business income calculations. The disallowed interest expense will also impact tax basis calculations of the partner or shareholder in their partnership or “S” corporation investment.

Congress also gave the IRS authorization to provide additional adjustments to the computation of adjusted taxable income as it deems necessary.

The limitation is effective for tax years beginning after 2017.

Research and Experimental Expenditures

Taxpayers generally use one of three methods to account for research and experimental expenditures, including (1) claiming a current deduction, (2) capitalizing and amortizing over at least 60 months, or (3) capitalizing and amortizing over 10 years.

Beginning in 2022, the Act requires specified research and development expenses to be capitalized and amortized over a five-year period (15 years if the research is conducted outside of the United States). The new rules do not apply to land acquisition or improvement costs or mine exploration costs (including oil and gas).

If property with respect to such research and development is retired, disposed of, or abandoned, then the asset will continue to be amortized over the remaining period. These provisions apply on a cutoff basis to expenditures paid or incurred in tax years beginning after December 31, 2021.

Note that there are no changes to the research and development credit.

Business Tax Credits

The Act generally leaves most business credits untouched; it does not address expiring credits. However, the following credits were amended or added:

- **Orphan Drug Credit** - Limits the orphan drug credit to 25% of qualified clinical testing expenses for the tax year.

OUR THOUGHTS ON...

RESEARCH EXPENSES

Taxpayers who previously gave little thought to their “research” activities (since any expense was typically automatically deducted) may now need to consider how to account for those expenditures, so they can be treated appropriately under the new rules. Taxpayers who were accustomed to expensing qualified research and development expenditures will realize the tax benefit of such deductions over an extended time period after 2021.

- Rehabilitation Credit - Provides a 20% credit (to be claimed ratably over a five-year period beginning in the tax year the structure is placed in service) for qualified rehabilitation expenditures with respect to a historic structure. This replaces a one-time credit of either 10% or 20% based upon a fixed percentage of rehabilitation costs.
- Employer Credit for Paid Family and Medical Leave - The Act provides a new credit to eligible employers that provide all qualifying full-time employees at least two weeks annual paid family and medical leave and allow part-time employees a commensurate amount of leave on a pro-rata basis. The credit is equal to 12.5% of the wages paid to qualifying employees during any period in which such employees are on leave provided leave pay is 50% of the wages normally paid to an employee. The credit increases when amounts paid under the employer plan exceed 50% of employee wages.
- Corporate AMT – See previous discussion on corporate alternative minimum tax (Page 19).
Transition from a Global Tax System to a Territorial Tax System

Historically, the U.S. was one of the few countries that taxed the global earnings of its constituents. Domestic income is generally taxed in the year in which it is earned, with the income of foreign subsidiaries (with some exceptions) taxed in the year in which the earnings and profits (E&P) of the foreign subsidiary are repatriated to the U.S. (usually as a dividend). As a result of this system, many profitable U.S. multinationals have kept their excess earnings offshore. It has been estimated that in excess of $3 trillion of foreign E&P of U.S. multinationals remains offshore. Many believe that this is the direct result of the U.S. global tax system.

With this Act, Congress has rewritten the U.S. rules on international taxation. Along with the reduction in corporate and pass-through tax rates, U.S. business taxation has shifted to a focus on U.S. domestic income (with a number of international anti-abuse measures put into place).

Dividends Received Deduction

U.S. corporate shareholders that own at least 10% of a foreign subsidiary paying dividends will now be eligible for a 100% dividends-received deduction (DRD) under the Act. This, in effect, removes any perceived barrier to repatriation. This deduction is available to corporations meeting certain criteria.

Since the DRD provides a 100% exemption from U.S. taxation, a U.S. corporate shareholder will no longer be able to claim an indirect foreign tax credit for foreign dividends.

Mandatory Deemed Repatriation of Accumulated E&P

A one-time “deemed repatriation” tax will be levied on any post-1986 accumulated E&P that has not previously been taxed. This levy applies to all U.S. persons (individuals included). For E&P held in cash and cash equivalents, the tax rate is 15.5%, with non-cash earnings taxed at 8%. Taxpayers will have the option to pay the tax over an eight-year period.

A number of special rules apply to the mandatory deemed repatriation, including, but not limited to, some allowance for existing net operating losses and foreign tax credit carryforwards. The U.S. shareholders of an “S” corporation that owns shares of a foreign corporation may elect to defer the deemed repatriation tax until a triggering event occurs.

Our Thoughts on...

NEED FOR ADDITIONAL FUTURE INTERNATIONAL GUIDANCE

Due to the complexity of the international tax law changes, there is a need for additional guidance from the IRS. As an example, Treasury issued Notice 2018-07 on December 29, 2017 to provide taxpayers with guidance in complying with the mandatory repatriation provisions.

Our Thoughts on...

MANDATORY REPATRIATION

Even though the 100% dividends received deduction applies solely to “C” corporations, the “toll charge” to transition to this new system applies to all “U.S. shareholders.” For these purposes, a U.S. shareholder includes domestic corporations, partnerships, trusts, estates and individuals that directly, indirectly or constructively own 10% or more of a specified foreign corporation’s voting power.

Modifications to Subpart F Income and Controlled Foreign Corporations

Subpart F Income

Historically, anti-deferral measures were established for certain types of income earned by controlled foreign
corporations (CFCs). A foreign corporation is a CFC if more than 50% of the corporation’s stock (either voting or by value) is owned by U.S. “persons” (which can be a mixture of corporations, individuals, and more).

These anti-deferral, or Subpart F, provisions require a U.S. shareholder to include in income, its share of tainted income, including: “moveable income” such as interest, dividends, rents and royalties, as well as income derived from certain related-party transactions. Any Subpart F income is then considered previously taxed income (PTI) and excluded from future taxation when the earnings are actually repatriated to the U.S.

The Act expands the definition of “U.S. shareholder” to include any “person” owning 10% of the value of all shares and classes of stock. This change will likely expand who is considered a “U.S. shareholder” for Subpart F purposes.

The Act also modifies the constructive ownership of CFCs by providing that stock held by a foreign corporation will be factored into determining whether a U.S. corporation is a “U.S. shareholder.” This appears to be targeting U.S. corporations with foreign subsidiaries that have inverted (moved their headquarters abroad) but impacts all foreign-owned U.S. multinational groups.

The Act expedites the recognition of Subpart F income by eliminating the “30-day rule” of stock ownership.

**New Anti-Base Erosion Provisions**

**Limiting Base Erosion from Hybrid Payments and Surrogate Foreign Corporation Dividends**

Congress has enacted a number of rules to limit “base erosion,” which is when a multinational enterprise (MNE) shifts income from one taxing jurisdiction to another (with a lower tax rate).

For hybrid payments, the Act denies a deduction for outgoing payments structured in a manner that takes advantage of the differing ways in which two (or more) countries tax the same financial arrangement. This provision is in line with the measures proposed by the Organization for Economic Cooperation and Development (OECD) in Action 2 of its recent Base Erosion Profit Shifting (BEPS) plan.

The limitation on lower tax rates on dividends received from surrogate foreign corporations was designed as a foil to the recent trend in corporate inversions. Any dividends received by U.S. corporate shareholders from surrogate foreign corporations (a former U.S. corporation that inverted to become a foreign) would not be eligible for the new dividends received deduction.

**Base Erosion and Anti-Abuse Tax (BEAT)**

The Act added a new base-erosion-focused minimum tax targeting foreign-headquartered companies. The tax will curtail the U.S. tax benefit of many cross-border related-party payments made by large multinational companies. Specifically, BEAT applies to domestic “C” corporations that are part of a multinational group with at least $500 million of annual domestic gross receipts (over a three-year averaging period) and which have a “base erosion percentage” of 3% or higher for the tax year. Targeted base erosion payments are amounts paid by the taxpayer to foreign-related parties for which a deduction is allowable (including amounts paid to a foreign-related party in connection with the acquisition of depreciable or amortizable property). There are limited exceptions for payments. A taxpayer’s base erosion percentage is determined by dividing the aggregate amount of base erosion tax benefits for the year by the aggregate amount of deductions allowable by the taxpayer for the year. The BEAT is computed through a multi-step formula used to determine the base erosion minimum tax amount.

**Foreign Tax Credit Modifications**

The Act adjusted tax rules for foreign tax credits and how items may be allocated.

First, as noted earlier, the deemed-paid, or indirect, credit on dividends received by a U.S. corporation from a 10%-owned foreign corporation has been repealed. A deemed-paid foreign tax credit is still allowed for items of Subpart F income.
Foreign branch income of U.S. corporations will now be allocated to specific and separate tax baskets. All non-passive income from qualified business units (QBU) will then be categorized. This will limit the aggressive tax play of mixing and matching different foreign incomes and credits.

For foreign tax credit purposes, the Act sources income from the production of inventory within the U.S. and sale outside of the U.S. (or vice versa) exclusively to the location of the inventory’s production.

**OUR THOUGHTS ON...**

**SECTION 863(B)**

Section 863(b) has been modified to provide that income from the manufacture of inventory within the U.S. and sold with title passing outside the U.S. (and vice versa) is no longer sourced 50/50 between U.S. and foreign sources. Rather, income from such transactions will be sourced solely to the place of production. Section 863(b) has historically provided an “easy source” of foreign source income to U.S. manufacturers (for purposes of claiming foreign tax credits). Taxpayers with excess foreign tax credits may need to re-evaluate their ability to benefit from excess foreign tax credits moving forward.

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**GILTI (Global Intangible Low-Taxed Income) and FDII (Foreign-Derived Intangible Income)**

International tax provisions in the new law are designed to encourage U.S. business to locate operations in the U.S. while preventing these same businesses from shifting income to a low-tax foreign jurisdiction(s) with nominal tangible asset investment. As such, the Act provides for a new category of Subpart F-type income for a U.S. shareholder’s share of a CFC’s global intangible low-taxed income (GILTI).

**GILTI**

The Act adds a new section that requires a U.S. shareholder to include in income (the GILTI) of its CFC. GILTI is defined as the excess of the U.S. shareholder’s CFC’s aggregate net “tested income” over the “net deemed tangible income return.”

“Tested income” is the gross income of the corporation determined without regard to the certain exceptions.

“Net deemed tangible income return” is defined as 10% of the excess of the shareholder’s basis in tangible property (QBAI or qualified business asset investment) used to produce tested income over the amount of interest expense allocated to net tested income.

There is a deduction equal to 50% of the GILTI, which is reduced to 37.5% starting in 2026. A U.S. corporate shareholder is then entitled to a foreign tax credit equal to 80% of the taxes paid or accrued with respect to the tested income of each CFC.

**OUR THOUGHTS ON...**

**GILTI AND FDII**

GILTI is the “stick” to ensure that U.S. multinationals pay a global minimum tax, while FDII is the “carrot” to incentivize U.S. corporations to produce goods and/or provide services to customers outside of the United States.

**FDII**

FDII is defined as a domestic corporation’s foreign-derived intangible income that is derived in connection with property sold by the taxpayer to a person who is not a U.S. person and that such property is for foreign use or disposition outside of the U.S. A domestic corporation is allowed a deduction equal to 37.5% of its FDII, which is reduced to 21.875% starting in 2026.

This provision serves as an incentive for a U.S. corporation to domestically produce goods and services for customers outside of the U.S.
FOR IMMEDIATE CONSIDERATION

- Planning for utilization of standard deduction versus itemizing deductions
- Review accounting method changes, including those for companies with gross receipts less than $25 million
- Debt vs. Equity – Impact of Interest Expense Limitations
- Planning for Section 199A 20% Qualified Business Income Deduction
- Re-evaluate International Planning Opportunities
- “S” vs. “C” Corporation Analysis
- Estate Tax Planning Window
- Tax-Exempt Organization UBIT Trade or Business Activity Identification