TAX REFORM

A Supplement to AICPA Tax and PFP Courses

TAX CUTS & JOBS ACT

A Special Report on the Tax Cuts and Jobs Act of 2017

On December 22, 2017, the President signed into law H.R. 1, known as the Tax Cuts and Jobs Act (TCJA), which made widespread changes to the Internal Revenue Code (IRC). Almost all its provisions, including a lower corporate tax rate of 21 percent and lower individual income tax rates, became effective on January 1, 2018.

Among the many changes to tax law was one that **permanently lowered the corporate income tax rate from 35 percent to 21 percent, effective for 2018**. The Senate version lowered the rate to 20 percent, but delayed its effective date until 2019, whereas the House bill originally had a 20 percent rate that would have been effective in 2018.

The law also **lowers the individual income tax rates through 2025. The new top rate is 37 percent, lowered from 39.6 percent**. The law keeps the same number of brackets as under prior law. It also keeps the individual alternative minimum tax (AMT), with a higher exemption than under prior law, but eliminates the corporate AMT.

In an interesting course of events, the House of Representatives passed H.R. 1, for a second time on December 20, 2017, by a vote of 224 to 201, after procedural objections were raised about the version of the bill the House passed the day before. The re-vote was necessary because the Senate version of the bill differed from the House version, after there was an objection that the bill the House had passed on Tuesday violated the Senate's so-called Byrd rule, named for former Sen. Robert Byrd, which prohibits the Senate from passing legislation using the budget reconciliation rules if the legislation contains extraneous provisions.

The Senate parliamentarian ruled that the bill as first passed by the House violated these rules.

The Senate's changes involved

- the removal of an expansion of the IRC Section 529 accounts that would have allowed distributions to be used for home-schooling expenses (Section 11032 of the bill); and
- the removal of an exception to the endowment excise tax for colleges with fewer than 500 tuition-paying students (Section 13701 of the bill).

— Sally P. Schreiber, JofA senior editor

Tax Reform Legislation: The Tax Cuts and Jobs Act

The Tax Cuts and Jobs Act includes several provisions that affect individual taxpayers. However, to keep the cost of the bill within Senate budget rules, all the changes affecting individuals will expire after 2025. At that time, if no future Congress acts to extend H.R. 1's provisions, the individual tax provisions will sunset, and the tax law will revert to its previous state.

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Adapted from [a *Journal of Accountancy* article] originally written by Sally P. Schreiber, *a* JofA senior editor and Alistair M. Nevius, the JofA's editor-in-chief, tax

What the Tax Reform Act Means for Individuals

A look at the key provisions in the law affecting individuals.

Tax Rates

For tax years 2018 through 2025, the following rates will apply to individual taxpayers.

Single Taxpayers

Taxable income over	But not over	Is taxed at
$0	$9,525	10%
$9,525	$38,700	12%
$38,700	$82,500	22%
$82,500	$157,500	24%
$157,500	$200,000	32%
$200,000	$500,000	35%
$500,000		37%

Heads of Households

Taxable income over	But not over	Is taxed at
$0	$13,600	10%
$13,600	$51,800	12%
$51,800	$82,500	22%
$82,500	$157,500	24%
$157,500	$200,000	32%
$200,000	$500,000	35%
$500,000		37%

Married Taxpayers Filing Joint Returns and Surviving Spouses

Taxable income over	But not over	Is taxed at
$0	$19,050	10%
$19,050	$77,400	12%
$77,400	$165,000	22%
$165,000	$315,000	24%
$315,000	$400,000	32%
$400,000	$600,000	35%
$600,000		37%

Married Taxpayers Filing Separately

Taxable income over	But not over	Is taxed at
$0	$9,525	10%
$9,525	$38,700	12%
$38,700	$82,500	22%
$82,500	$157,500	24%
$157,500	$200,000	32%
$200,000	$300,000	35%
$300,000		37%

Estates and Trusts

Taxable income over	But not over	Is taxed at
$0	$2,550	10%
$2,550	$9,150	24%
$9,150	$12,500	35%
$12,500		37%

Special brackets will apply for certain children with unearned income.

Capital gains and qualified dividends: The system for taxing capital gains and qualified dividends does not change under the new law, except that the income levels at which the 15 percent and 20 percent rates apply were altered (and will be adjusted for inflation after 2018). For 2018, the 15 percent rate will start at $77,200 for married taxpayers filing jointly, $51,700 for heads of household, and $38,600 for other individuals. The 20 percent rate will start at $479,000 for married taxpayers filing jointly, $452,400 for heads of household, and $425,800 for other individuals.

Standard deduction: The TCJA increased the standard deduction through 2025 for individual taxpayers to $24,000 for married taxpayers filing jointly, $18,000 for heads of household, and $12,000 for all other individuals. The additional standard deduction for elderly and blind taxpayers was not changed by the act.

Personal exemptions: The TCJA repealed all personal exemptions through 2025. The withholding rules will be modified to reflect the fact that individuals can no longer claim personal exemptions.

Pass-Through Income Deduction

For tax years after 2017 and before 2026, individuals will be allowed to deduct 20 percent of “qualified business income” (QBI) from a partnership, S corporation, or sole proprietorship, as well as 20 percent of qualified real estate investment trust (REIT) dividends, qualified cooperative dividends, and qualified publicly traded partnership income. (Special rules would apply to specified agricultural or horticultural cooperatives.)

A limitation on the deduction is phased in based on W-2 wages above a threshold amount of taxable income. The deduction is disallowed for specified service trades or businesses with income above a threshold.

For these purposes, “qualified business income” means the net amount of qualified items of income, gain, deduction, and loss with respect to the qualified trade or business of the taxpayer. These items must be effectively connected with the conduct of a trade or business within the United States. They do not include specified investment-related income, deductions, or losses.

“Qualified business income” does not include an S corporation shareholder’s reasonable compensation, guaranteed payments, or—to the extent provided in regulations—payments to a partner who is acting in a capacity other than his or her capacity as a partner.

“Specified service trades or businesses” include any trade or business in the fields of accounting, health, law, consulting, athletics, financial services, brokerage services, or any business in which the principal asset of the business is the reputation or skill of one or more of its employees.

The exclusion from the definition of a qualified business for specified service trades or businesses phases out for a taxpayer with taxable income in excess of $157,500, or $315,000 in the case of a joint return.

For each qualified trade or business, the taxpayer is allowed to deduct 20 percent of the qualified business income for that trade or business. Generally, the deduction is limited to 50 percent of the W-2 wages paid with respect to the business. Alternatively, capital-intensive businesses may get a higher benefit under a rule that takes into consideration 25 percent of wages paid plus a portion of the business’ basis in its tangible assets. However, if the taxpayer’s income is below the threshold amount, the deductible amount for each qualified trade or business is equal to 20 percent of the qualified business income for each respective trade or business.

Proposed Rules

The IRS issued proposed regulations regarding the qualified trade or business income deduction under Sec. 199A, which was enacted by TCJA. At the same time, it issued Notice 2018-64, which provides guidance on how to compute W-2 wages for purposes of the deduction, along with frequently asked questions on its website (available at www.irs.gov). The proposed rules include a way that taxpayers can group or aggregate separate trades or businesses and an anti-abuse rule designed to prevent taxpayers from separating out parts of an otherwise disqualified business in an attempt to qualify those separated parts for the Sec. 199A deduction.

Sec. 199A provides a deduction of up to 20% of income from a domestic business operated as a sole proprietorship or through a partnership, S corporation, trust, or estate. It may be taken by individuals and by some estates and trusts. The deduction is generally equal to the lesser of 20% of the taxpayer's QBI plus 20% of the taxpayer's qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income, or 20% of taxable income minus net capital gains.

For taxpayers whose taxable income exceeds a threshold amount ($315,000 for taxpayers filing joint returns and $157,500 for other taxpayers in 2018), the deduction may be limited based on the type of trade or business engaged in by the taxpayer, the wages paid with respect to the trade or business, and/or the unadjusted basis immediately after acquisition of qualified property held for use in the trade or business. These limitations are subject to phase-in rules based upon taxable income above the threshold amount. The application of those limits is described in the proposed regulations.

The Service noted that, although the rules will not be effective until published as final in the *Federal Register*, taxpayers may rely on them until then.

Prop. Regs. Sec. 1.199A-1 contains the operational rules, including how to determine the deduction for taxpayers with incomes at or below the threshold amounts and for those with incomes above the thresholds. It also defines the following terms: aggregated trade or business, applicable percentage, phase-in range, qualified business income, QBI component, qualified PTP income, qualified REIT dividends, reduction amount, relevant passthrough entity (RPE), specified service trade or business (SSTB), threshold amount, total QBI amount, unadjusted basis immediately after acquisition (UBIA) of qualified property, and W-2 wages.

The definition of a trade or business is also in this section; the IRS decided to apply the definition of "trade or business" under Sec. 162(a) because it is derived from a large amount of case law and administrative guidance in the context of a broad range of industries.

Prop. Regs. Sec. 1.199A-2 contains rules for determining W-2 wages and the UBIA of qualified property, both of which are components in calculating limitations on the deduction. The rules for determining W-2 wages are based on the rules under the repealed Sec. 199 deduction for qualified domestic production activities, except, unlike Sec. 199, the Sec. 199A W-2 wages are determined separately for each trade or business.

Prop. Regs. Sec. 1.199A-3 restates the definitions in Sec. 199A(c) and provides additional guidance on the determination of QBI, qualified REIT dividends, and qualified PTP income.

Prop. Regs. Sec. 1.199A-4 contains aggregation rules allowing separate trades or businesses to be grouped when applying the Sec. 199A rules. The IRS rejected comments suggesting the application of the grouping rules under Sec. 469, the passive loss provision, and instead proposed a flexible method that looks into common ownership, shared services, and other commonality, but specifically excludes SSTBs from being aggregated under the rules. The regulations impose a duty of consistency that requires that once multiple trades or businesses are aggregated into a single aggregated trade or business under Sec. 199A, taxpayers must consistently report the aggregated group in subsequent tax years. Aggregation allows for ease of administration and was one of the AICPA's recommendations (available at www.aicpa.org) in a letter it sent to the IRS in February.

Child Tax Credit

The TCJA increased the amount of the child tax credit to $2,000 per qualifying child. The maximum refundable amount of the credit is $1,400. The act also created a new nonrefundable $500 credit for qualifying dependents who are not qualifying children. The threshold at which the credit begins to phase out was increased to $400,000 for married taxpayers filing a joint return and $200,000 for other taxpayers.

Other Credits for Individuals

The House version of the bill *would* have repealed several credits that are retained in the final version of the act. They included the following:

- Section 22 credit for the elderly and permanently disabled
- Section 30D credit for plug-in electric drive motor vehicles
- Section 25 credit for interest on certain home mortgages

The House bill's proposed modifications to the American opportunity tax credit and lifetime learning credit also did *not* make it into the final act.

Education Provisions

The TCJA modifies Section 529 plans to allow them to distribute no more than $10,000 in expenses for tuition incurred during the tax year at an elementary or secondary school. This limitation applies on a per-student basis, rather than on a per-account basis.

The act modified the exclusion of student loan discharges from gross income by including within the exclusion certain discharges on account of death or disability.

The House bill's provisions repealing the student loan interest deduction and the deduction for qualified tuition and related expenses were not retained in the final act.

The House bill's proposed repeal of the exclusion for interest on Series EE savings bonds used for qualified higher education expenses and repeal of the exclusion for educational assistance programs did *not* appear in the final act.

Itemized Deductions

The TCJA repealed the overall limitation on itemized deductions through 2025.

Mortgage interest: The home mortgage interest deduction was modified to reduce the limit on acquisition indebtedness to $750,000 (from the prior-law limit of $1 million).

A taxpayer who entered into a binding written contract before December 15, 2017, to close on the purchase of a principal residence before January 1, 2018, and who purchases that residence before April 1, 2018, will be considered to have incurred acquisition indebtedness prior to December 15, 2017, under this provision, meaning that he or she will be allowed the prior-law $1 million limit.

Home-equity loans: The home-equity loan interest deduction is repealed through 2025.

State and local taxes: Under the TCJA, individuals are allowed to deduct up to $10,000 ($5,000 for married taxpayers filing separately) in state and local income or property taxes.

The conference report on the bill specifies that taxpayers cannot take a deduction in 2017 for prepaid 2018 state income taxes.

Casualty losses: Under the TCJA, taxpayers can take a deduction for casualty losses only if the loss is attributable to a presidentially declared disaster.

Gambling losses: The TCJA clarified that the term "losses from wagering transactions" in Section 165(d) includes any otherwise allowable deduction incurred in carrying on a wagering transaction. This is intended, according to the conference report, to clarify that the limitation of losses from wagering transactions applies not only to the actual costs of wagers, but also to other expenses the taxpayer incurred in connection with his or her gambling activity.

Charitable contributions: The TCJA increased the income-based percentage limit for charitable contributions of cash to public charities to 60 percent. It also denies a charitable deduction for payments made for college athletic event seating rights. Finally, it repealed the statutory provision that provides an exception to the contemporaneous written acknowledgment requirement for certain contributions that are reported on the donee organization's return—a prior-law provision that had never been put in effect because regulations were never issued.

Miscellaneous itemized deductions: All miscellaneous itemized deductions subject to the 2 percent floor under current law are repealed through 2025 by the act.

Medical expenses: The TCJA reduced the threshold for deduction of medical expenses to 7.5 percent of adjusted gross income for 2017 and 2018.

Other Provisions for Individuals

Alimony: For any divorce or separation agreement executed after December 31, 2018, the act provides that alimony and separate maintenance payments are not deductible by the payer spouse. It repealed the provisions that provided that those payments were includible in income by the payee spouse.

Moving expenses: The moving expense deduction is repealed through 2025, except for members of the armed forces on active duty who move pursuant to a military order and incident to a permanent change of station.

Archer MSAs: The House bill would have eliminated the deduction for contributions to Archer medical savings accounts (MSAs); the final act did not include this provision.

Educators' classroom expenses: The final act did not change the allowance of an above-the-line $250 deduction for educators' expenses incurred for professional development or to purchase classroom materials.

Exclusion for bicycle commuting reimbursements: The act repealed through 2025 the exclusion from gross income or wages of qualified bicycle commuting expenses.

Sale of a principal residence: The TCJA did not change the current rules regarding exclusion of gain from the sale of a principal residence.

Moving expense reimbursements: The TCJA repealed through 2025 the exclusion from gross income and wages for qualified moving expense reimbursements, except in the case of a member of the armed forces on active duty who moves pursuant to a military order.

IRA Recharacterizations

The TCJA excludes conversion contributions to Roth IRAs from the rule that allows IRA contributions to one type of IRA to be recharacterized as a contribution to the other type of IRA. This is designed to prevent taxpayers from using recharacterization to unwind a Roth conversion.

Estate, Gift, and Generation-Skipping Transfer Taxes

The TCJA doubles the estate and gift tax exemption for estates of decedents dying and gifts made after December 31, 2017, and before January 1, 2026. The basic exclusion amount provided in Section 2010(c)(3) increased from $5 million to $10 million and will be indexed for inflation occurring after 2011.

Individual AMT

Although the House version of the bill would have repealed the AMT for individuals, the final act kept the tax, but increased the exemption.

For tax years beginning after December 31, 2017, and beginning before January 1, 2026, the AMT exemption amount increases to $109,400 for married taxpayers filing a joint return (half this amount for married taxpayers filing a separate return) and $70,300 for all other taxpayers (other than estates and trusts). The phaseout thresholds are increased to $1 million for married taxpayers filing a joint return and $500,000 for all other taxpayers (other than estates and trusts). The exemption and threshold amounts will be indexed for inflation.

Individual Mandate

The TCJA reduces to zero the amount of the ACA healthcare penalty, under Section 5000A, imposed on taxpayers who do not obtain health insurance that provides at least minimum essential coverage, effective after 2018.

How the Tax Law Affects Business Taxes

The TCJA contains numerous changes that effect businesses large and small. The act makes sweeping modifications to the IRC, including

- implementing a much lower corporate tax rate,
- changes to credits and deductions, and
- a move to a territorial system for corporations that have overseas earnings.

Here are the key business provisions of the TCJA.

Corporate Tax Rate

The TCJA replaced the prior-law graduated corporate tax rate, which taxed income over $10 million at 35 percent, with a flat rate of 21 percent. The House version of the bill had provided for a special 25 percent rate on personal service corporations, but that special rate did not appear in the final act. The new rate took effect January 1, 2018.

Corporate AMT

The TCJA repealed the corporate AMT.

Depreciation

Bonus depreciation: The TCJA extended and modified bonus depreciation under Section 168(k), allowing businesses to immediately deduct 100 percent of the cost of eligible property in the year it is placed in service, through 2022. The amount of allowable bonus depreciation will then be phased down over 4 years: 80 percent will be allowed for property placed in service in 2023, 60 percent in 2024, 40 percent in 2025, and 20 percent in 2026. (For certain properties with long production periods, these dates will be pushed out a year.)

The TCJA also removed the rule that made bonus depreciation available only for new property.

Luxury automobile depreciation limits: The TCJA increased the depreciation limits under Section 280F that apply to listed property. For passenger automobiles placed in service after 2017 and for which bonus depreciation is not claimed, the maximum amount of allowable depreciation is $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.

Section 179 expensing: The TCJA increased the maximum amount a taxpayer may expense under Section 179 to $1 million and increased the phaseout threshold to $2.5 million. These amounts will be indexed for inflation after 2018.

The act also expanded the definition of Section 179 property to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging. It also expanded the definition of qualified real property eligible for Section 179 expensing to include any of the following improvements to nonresidential real property: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

Accounting Methods

Cash method of accounting: The TCJA expanded the list of taxpayers that are eligible to use the cash method of accounting by allowing taxpayers that have average annual gross receipts of $25 million or less in the 3 prior tax years to use the cash method. The $25 million gross-receipts threshold will be indexed for inflation after 2018. Under the provision, the cash method of accounting may be used by taxpayers, other than tax shelters, that satisfy the gross-receipts test, regardless of whether the purchase, production, or sale of merchandise is an income-producing factor.

Farming C corporations (or farming partnerships with a C corporation partner) will be allowed to use the cash method if they meet the $25 million gross-receipts test.

The current-law exceptions from the use of the accrual method otherwise remain the same, so qualified personal service corporations, partnerships without C corporation partners, S corporations, and other pass-through entities continue to be allowed to use the cash method without regard to whether they meet the $25 million gross-receipts test, so long as the use of that method clearly reflects income.

Inventories: Taxpayers that meet the cash method $25 million gross-receipts test will also not be required to account for inventories under Section 471. Instead, they will be allowed to use an accounting method that either treats inventories as nonincidental materials and supplies or conforms to their financial accounting treatment of inventories.

UNICAP: Taxpayers that meet the cash method $25 million gross-receipts test are exempted from the uniform capitalization rules of Section 263A. (The exemptions from the UNICAP rules that are not based on gross receipts are retained in the law.)

Expenses and Deductions

Interest deduction limitation: Under the TCJA, the deduction for business interest is limited to the sum of (1) business interest income; (2) 30 percent of the taxpayer's adjusted taxable income for the tax year; and (3) the taxpayer's floor plan financing interest for the tax year. Any disallowed business interest deduction can be carried forward indefinitely (with certain restrictions for partnerships).

Any taxpayer that meets the $25 million gross-receipts test is exempt from the interest deduction limitation. The limitation will also not apply to any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. Farming businesses are allowed to elect out of the limitation.

For these purposes, business interest means any interest paid or accrued on indebtedness properly allocable to a trade or business. Business interest income means the amount of interest includible in the taxpayer's gross income for the tax year that is properly allocable to a trade or business. However, business interest does not include investment interest, and business interest income does not include investment income, within the meaning of Section 163(d).

Floor plan financing interest means interest paid or accrued on indebtedness used to finance the acquisition of motor vehicles held for sale or lease to retail customers and secured by the inventory so acquired.

Net operating losses: The TCJA limits the deduction for net operating losses (NOLs) to 80 percent of taxable income (determined without regard to the deduction) for losses. (Property and casualty insurance companies are exempt from this limitation.)

Taxpayers are allowed to carry NOLs forward indefinitely. The two-year carryback and special NOL carryback provisions were repealed. However, farming businesses are still allowed a two-year NOL carryback.

Like-kind exchanges: Under the TCJA, like-kind exchanges under Section 1031 will be limited to exchanges of real property that is not primarily held for sale. This provision generally applies to exchanges completed after December 31, 2017. However, an exception is provided for any exchange if the property disposed of by the taxpayer in the exchange was disposed of on or before December 31, 2017, or the property received by the taxpayer in the exchange was received on or before that date.

Domestic production activities: The TCJA repealed the Section 199 domestic production activities deduction.

Entertainment expenses: The TCJA disallows a deduction for (1) an activity generally considered to be entertainment, amusement, or recreation; (2) membership dues for any club organized for business, pleasure, recreation, or other social purposes; or (3) a facility or portion thereof used in connection with any of these items.

Qualified transportation fringe benefits: The TCJA disallows a deduction for expenses associated with providing any qualified transportation fringe to employees of the taxpayer and, except as necessary for ensuring the safety of an employee, any expense incurred for providing transportation (or any payment or reimbursement) for commuting between the employee's residence and place of employment.

Meals: Under the TCJA, taxpayers are still generally able to deduct 50 percent of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel). For amounts incurred and paid after December 31, 2017, and until December 31, 2025, the act expands this 50 percent limitation to expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for *de minimis* fringes and for the convenience of the employer. Such amounts incurred and paid after December 31, 2025, will not be deductible.

The IRS issued guidance clarifying that taxpayers may generally continue to deduct 50% of the food and beverage expenses associated with operating their trade or business, despite changes to the meal and entertainment expense deduction under Sec. 274 made by the TCJA (Notice 2018-76). According to the IRS, the amendments specifically deny deductions for expenses for entertainment, amusement, or recreation, but do not address the deductibility of expenses for business meals. This omission has created a lot of confusion in the business community, which the IRS is addressing in this interim guidance. Taxpayers can rely on the guidance in the notice until the IRS issues proposed regulations.

Sec. 274(k), which was not amended by the TCJA, does not allow a deduction for the expense of any food or beverages unless (1) the expense is not lavish or extravagant under the circumstances, and (2) the taxpayer (or an employee of the taxpayer) is present when the food or beverages are furnished. Sec. 274(n)(1), which was amended by the TCJA, generally provides that the amount allowable as a deduction for any expense for food or beverages cannot exceed 50% of the amount of the expense that otherwise would be allowable.

Under the interim guidance, taxpayers may deduct 50% of an otherwise allowable business meal expense if:

1. The expense is an ordinary and necessary business expense under Sec. 162(a) paid or incurred during the tax year when carrying on any trade or business;
2. The expense is not lavish or extravagant under the circumstances;
3. The taxpayer, or an employee of the taxpayer, is present when the food or beverages are furnished;
4. The food and beverages are provided to a current or potential business customer, client, consultant, or similar business contact; and
5. For food and beverages provided during or at an entertainment activity, they are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts.

The IRS will not allow the entertainment disallowance rule to be circumvented through inflating the amount charged for food and beverages.

The notice contains three examples illustrating how the IRS intends to interpret these rules. All three examples involve attending a sporting event with a business client and having food and drink while attending the game. The examples follow the AICPA's recommendation that meal expenses be deductible when their costs are separately stated from the cost of the entertainment.

The IRS plans to issue proposed regulations and is requesting comments by Dec. 2 on the notice. It is also asking for comments on:

- Whether further guidance is needed to clarify the interaction of Sec. 274(a)(1)(A) entertainment expenses and business meal expenses.
- Whether the definition of entertainment in Regs. Sec. 1.274-2(b)(1)(i) should be retained and, if so, whether it should be revised.
- Whether the objective test in Regs. Sec. 1.274-2(b)(1)(ii) should be retained and, if so, whether it should be revised.
- Whether the IRS should provide more examples in the regulations.

In a letter to the IRS dated April 2, 2018, the AICPA had requested that the IRS provide immediate guidance on the TCJA change to Sec. 274. The AICPA recommended that the IRS confirm that business meals (1) that take place between a business owner or employee and a current or prospective client; (2) that are not lavish or extravagant under the circumstances; and (3) where the taxpayer has a reasonable expectation of deriving income or other specific trade or business benefit from the encounter are deductible.

Partnership technical terminations: The TCJA repealed the Section 708(b)(1)(B) rule providing for technical terminations of partnerships under specified circumstances. The provision does not change the rule of Section 708(b)(1)(A) that a partnership is considered 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.

Carried interests: The TCJA provides for a three-year holding period in the case of certain net long-term capital gain with respect to any applicable partnership interest held by the taxpayer. It treats as short-term capital gain taxed at ordinary income rates the amount of a taxpayer's net long-term capital gain with respect to an applicable partnership interest if the partnership interest has been held for fewer than three years.

The conference report for the act clarified that the three-year holding requirement applies notwithstanding the rules of Section 83 or any election in effect under Section 83(b).

Amortization of research and experimental expenditures: Under the TCJA, amounts defined as specified research or experimental expenditures must be capitalized and amortized ratably over a five-year period. Specified research or experimental expenditures that are attributable to research that is conducted outside of the United States must be capitalized and amortized ratably over a 15-year period.

Year of inclusion: The TCJA requires accrual-method taxpayers subject to the all-events test to recognize items of gross income for tax purposes in the year in which they recognize the income on their applicable financial statement (or another financial statement under rules to be specified by the IRS). The act provides an exception for taxpayers without an applicable or other specified financial statement.

Business Credits

The TCJA modified a number of credits available to businesses. The House version of the act *would have* repealed a large number of business credits, but the final act generally did not repeal those credits. Changes to business credits in the final act include the following.

Orphan drug credit: The amount of the Section 45C credit for clinical testing expenses for drugs for rare diseases or conditions is reduced to 25 percent (from the prior 50 percent).

Rehabilitation credit: The TCJA modified the Section 47 rehabilitation credit to repeal the 10 percent credit for pre-1936 buildings and retain the 20 percent credit for certified historic structures. However, the credit must be claimed over a five-year period.

Employer credit for paid family or medical leave: The TCJA allows eligible employers to claim a credit equal to 12.5 percent of the amount of wages paid to a qualifying employee during any period in which the employee is on family and medical leave if the rate of payment under the program is 50 percent of the wages normally paid to the employee. The credit is increased by 0.25 percentage points (but not above 25 percent) for each percentage point by which the rate of payment exceeds 50 percent. The maximum amount of family and medical leave that may be taken into account for any employee in any tax year is 12 weeks. However, the credit is only available in 2018 and 2019.

Compensation

Covered employees: Section 162(m) limits the deductibility of compensation paid to certain covered employees of publicly traded corporations. Prior law defined a covered employee as the chief executive officer and the four most highly compensated officers (other than the CEO). The act revised the definition of a covered employee under Section 162(m) to include both the principal executive officer and the principal financial officer and reduced the number of other officers included to the three most highly compensated officers for the tax year. The act also requires that if an individual is a covered employee for any tax year (after 2016), that individual will remain a covered employee for all future years. The act also removed prior-law exceptions for commissions and performance-based compensation.

The TCJA includes a transition rule so that the changes do not apply to any remuneration under a written binding contract that was in effect on November 2, 2017, and that was not later modified in any material respect.

Qualified equity grants: The TCJA allows a qualified employee to elect to defer, for income tax purposes, the inclusion in income of the amount of income attributable to qualified stock transferred to the employee by the employer. An election to defer income inclusion for qualified stock must be made no later than 30 days after the first time the employee's right to the stock is substantially vested or is transferable, whichever occurs earlier.

Taxation of Foreign Income

The TCJA provides a 100 percent deduction for the foreign-source portion of dividends received from "specified 10 percent-owned foreign corporations" by domestic corporations that are U.S. shareholders of those foreign corporations within the meaning of Section 951(b).

The conference report says that the term "dividend received" is intended to be interpreted broadly, consistent with the meaning of the phrases "amount received as dividends" and "dividends received" under Sections 243 and 245, respectively.

A specified 10 percent-owned foreign corporation is any foreign corporation (other than a passive foreign investment company [PFIC] that is not also a controlled foreign corporation [CFC]) with respect to which any domestic corporation is a U.S. shareholder.

The deduction is not available for any dividend received by a U.S. shareholder from a CFC if the dividend is a hybrid dividend. A hybrid dividend is an amount received from a CFC for which a deduction would be allowed under this provision and for which the specified 10 percent-owned foreign corporation received a deduction (or other tax benefit) from any income, war profits, and excess profits taxes imposed by a foreign country.

Foreign tax credit: No foreign tax credit or deduction will be allowed for any taxes paid or accrued with respect to a dividend that qualifies for the deduction.

Holding period: A domestic corporation will not be permitted a deduction for any dividend on any share of stock that is held by the domestic corporation for 365 days or fewer during the 731-day period beginning on the date that is 365 days before the date on which the share becomes ex-dividend with respect to the dividend.

Deemed repatriation: The TCJA generally requires that, for the last tax year beginning before January 1, 2018, any U.S. shareholder of a specified foreign corporation must include in income its pro rata share of the accumulated post-1986 deferred foreign income of the corporation. For purposes of this provision, a specified foreign corporation is any foreign corporation in which a U.S. person owns a 10 percent voting interest. It excludes PFICs that are not also CFCs.

A portion of that pro rata share of foreign earnings is deductible; the amount of the deductible portion depends on whether the deferred earnings are held in cash or other assets. The deduction results in a reduced rate of tax on income from the required inclusion of pre-effective date earnings. The reduced rate of tax is 15.5 percent for cash and cash equivalents and 8 percent for all other earnings. A corresponding portion of the credit for foreign taxes is disallowed, thus limiting the credit to the taxable portion of the included income. The separate foreign tax credit limitation rules of current-law Section 904 apply, with coordinating rules. The increased tax liability generally may be paid over an eight-year period. Special rules are provided for S corporations and REITs.

Foreign intangible income: The TCJA provides domestic C corporations (that are not regulated investment companies or REITs) with a reduced tax rate on "foreign-derived intangible income" (FDII) and "global intangible low-taxed income" (GILTI). FDII is the portion of a domestic corporation's intangible income that is derived from serving foreign markets, using a formula in a new Section 250. GILTI will be defined in a new Section 951A.

The effective tax rate on FDII will be 13.125 percent in tax years beginning after 2017 and before 2026 and 16.406 percent after 2025. The effective tax rate on GILTI will be 10.5 percent in tax years beginning after 2017 and before 2026 and 13.125 percent after 2025.

Definition of U.S. shareholder: The TCJA amended the ownership attribution rules of Section 958(b) to expand the definition of "U.S. shareholder" to include a U.S. person who owns at least 10 percent of the value of the shares of the foreign corporation.

Adapted from articles originally appearing in the *Journal of Accountancy* as "What the Tax Reform Bill Means for Individuals," and "How Tax Overhaul Would Change Business Taxes."

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