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TAX REFORM
THE TAX CUTS AND JOBS ACT (TCJA)

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Unless otherwise indicated, all references to "Section", "§____", and the "Code" are to the specified section in the Internal Revenue Code of 1986, as amended, and to the Code itself. All references to "Regulation", "Regulations", and "Regs" are to the Treasury Regulations issued with respect to the Code. All references to the "Service" or "IRS" are to the Internal Revenue Service.

I.

TCJA PROVISIONS THAT HAVE AN IMPACT ON INDIVIDUALS, ESTATES, AND TRUSTS. UNLESS OTHERWISE NOTED, THE CHANGES ARE EFFECTIVE FOR TAX YEARS BEGINNING IN 2018 THROUGH 2025.

1. Ordinary Income Tax Rates.

Rate changes for individuals, estates, and trusts. Ordinary income is taxed at increasing rates that apply to different ranges of income depending on the filing status (single; married filing jointly, including surviving spouse; married filing separately; and head of household). The pre-TCJA rates were 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%.

TCJA rates. Beginning with the 2018 tax year and continuing through 2025, there will still be seven tax brackets for individuals, and the percentage rates will change to: 10%, 12%, 22%, 24%, 32%, 35%, and 37%.

Revenue Procedure 2018-57, sets forth certain inflation-adjusted items for 2019 for various provisions of the Code, subsequent to the Act. For taxable years beginning in 2019, the tax rate tables under §1 are as follows:

TABLE 1 - Married Individuals Filing Joint Returns and Surviving Spouses

If Taxable Income Is:	**The Tax Is:**
Not over $19,400	10% of the taxable income
Over $19,400 but not over $78,950	$1,940 plus 12% of the excess over $19,400
Over $78,950 but not over $168,400	$9,086 plus 22% of the excess over $78,950
Over $168,400 but not over $321,450	$28,765 plus 24% of the excess over $168,400
Over $321,450 but not over $408,200	$65,497 plus 32% of the excess over $321,450
Over $408,200 but not over $612,350	$93,257 plus 35% of the excess over $408,200
Over $612,350	$164,709.50 plus 37% of the excess over $612,350

[Over $480,050	$134,244 plus 39.6% of the excess over $480,050]

TABLE 2 - Heads of Households

If Taxable Income Is:	**The Tax Is:**
Not over $13,850	10% of the taxable income
Over $13,850 but not over $52,850	$1,385 plus 12% of the excess over $13,850
Over $52,850 but not over $84,200	$6,065 plus 22% of the excess over $52,850
Over $84,200 but not over $160,700	$12,962 plus 24% of the excess over $84,200
Over $160,700 but not over $204,100	$31,322 plus 32% of the excess over $160,700
Over $204,100 but not over $510,300	$45,210 plus 35% of the excess over $204,100
Over $510,300	$152,380 plus 37% of the excess over $510,300
[Over $453,350	$129,458 plus 39.6% of the excess over $453,350]

TABLE 3 - Unmarried Individuals (other than Surviving Spouses and Heads of Households)

If Taxable Income Is:	**The Tax Is:**
Not over $9,700	10% of the taxable income
Over $9,700 but not over $39,475	$970 plus 12% of the excess over $9,700
Over $39,475 but not over $84,200	$4,543 plus 22% of the excess over $39,475

If Taxable Income Is:	The Tax Is:
Over $84,200 but not over $160,725	$14,382.50 plus 24% of the excess over $84,200
Over $160,725 but not over $204,100	$32,748.50 plus 32% of the excess over $160,725
Over $204,100 but not over $510,300	$46,628.50 plus 35% of the excess over $204,100
Over $510,300	$153,798.50 plus 37% of the excess over $510,300
[Over $426,700	$123,916.25 plus 39.6% of the excess over $426,700]

TABLE 4 - Married Individuals Filing Separate Returns

If Taxable Income Is:	The Tax Is:
Not over $9,700	10% of the taxable income
Over $9,700 but not over $39,475	$970 plus 12% of the excess over $9,700
Over $39,475 but not over $84,200	$4,543 plus 22% of the excess over $39,475
Over $84,200 but not over $160,725	$14,382.50 plus 24% of the excess over $84,200
Over $160,725 but not over $204,100	$32,748.50 plus 32% of the excess over $160,725
Over $204,100 but not over $306,175	$46,628.50 plus 35% of the excess over $204,100
Over $306,175	$82,354.75 plus 37% of the excess over $306,175
[Over $240,025	$67,122 plus 39.6% of the excess over $240,025]

TABLE 5 - Estates and Trusts

If Taxable Income Is:	**The Tax Is:**
Not over $2,600	10% of the taxable income
Over $2,600 but not over $9,300	$260 plus 24% of the excess over $2,600
Over $9,300 but not over $12,750	$1,868 plus 35% of the excess over $9,300
Over $12,750	$3,075.50 plus 37% of the excess over $12,750
[Over $12,700	$3,283 plus 39.6% of the excess over $12,700]

Note: The numbers in brackets are the pre-TCJA top rates.

2. *Capital gain rates*. Three tax brackets currently apply to net capital gains, including certain kinds of dividends of individuals and other noncorporate taxpayers: 0% for net capital gain that would be taxed at the 10% or 15% rate if it were ordinary income; 15% for gain that would be taxed above 15% and below 39.6% if it were ordinary income; or 20% for gain that would be taxed at the 39.6% ordinary income rate.

The TCJA keeps the existing rates and adjusts the breakpoints on net capital gains and qualified dividends. For taxable years beginning in 2019, the Maximum Zero Rate Amount is $78,750 in the case of a joint return or surviving spouse, $52,750 in the case of an individual who is a head of household, $39,375 in the case of any other individual (other than an estate or trust), and $2,650 in the case of an estate or trust. The Maximum 15% Rate Amount is $488,850 in the case of a joint return or surviving spouse (½ such amount in the case of a married individual filing a separate return), $461,700 in the case of an individual who is the head of a household, $434,550 in the case of any other individual (other than an estate or trust), and $12,950 in the case of an estate or trust. Amounts above the Maximum 15% Rate Amount are taxed at 20%.

3. Standard Deduction. The pre-TCJA standard deduction was $12,700 for married taxpayers filing jointly, and $6,350 for single taxpayers. TCJA increases the standard deduction. For taxable years beginning in 2019, the standard deduction amounts under §63(c)(2) are as follows:

Filing Status	Standard Deduction
Married Individuals Filing Joint Returns and Surviving Spouses	$24,400
Heads of Households	$18,350
Unmarried Individuals (other than Surviving Spouses and Heads of Households)	$12,200
Married Individuals Filing Separate Returns	$12,200

4. Exemptions. TCJA suspends the deduction for personal exemptions. Thus, starting in 2018, taxpayers can no longer claim personal or dependency exemptions. In lieu of the deduction for personal exemptions, an estate is allowed a deduction of $600, a complex trust is allowed a deduction of $100, and a simple trust (required to distribute all of its income currently) is allowed a deduction of $300. These deduction amounts are not changed by TCJA.

5. New Deduction for "Qualified Business Income". Starting in 2018, taxpayers are allowed a deduction equal to 20% of "qualified business income," or "pass-through" income, i.e. income from partnerships, S corporations, LLCs, and sole proprietorships. See III and Exhibit B.

6. Child and Family Tax Credit. Prior to TCJA, the child tax credit was $1,000 per qualifying child, but it was reduced for married couples filing jointly by $50 for every $1,000 (or part of a $1,000) by which their adjusted gross income (AGI) exceeded $110,000. The threshold was $55,000 for married couples filing separately, and $75,000 for unmarried taxpayers. To the extent the $1,000-per-child credit exceeded your tax liability, it resulted in a refund up to 15% of your earned income (e.g., wages, or net self-employment income) above $3,000. For taxpayers with three or more qualifying children, the excess of the taxpayer's social security taxes for the year over the taxpayer's earned income credit for the year was refundable. In all cases, the refund was limited to $1,000 per qualifying child.

Starting in 2018, the TCJA doubles the child tax credit to $2,000 per qualifying child under 17. It also allows a new $500 credit (per dependent) for any of your dependents who are not qualifying children under 17. There is no age limit for the $500 credit, but the tax tests for dependency must be met. Under the TCJA, the refundable portion of the credit is increased to a maximum of $1,400 per qualifying child. In addition, the earned threshold is decreased to $2,500 (from $3,000 under pre-TCJA law), which has the potential to result in a larger refund. The $500 credit for dependents other than qualifying children is nonrefundable.

The TCJA substantially increases the "phase-out" thresholds for the credit. Starting in 2018, the total credit amount allowed to a married couple filing jointly is reduced by $50 for every $1,000 (or part of a $1,000) by which their AGI exceeds $400,000 (up from the pre-TCJA threshold of $110,000). The threshold is $200,000 for all other taxpayers.

In order to claim the credit for a qualifying child, you *must* include that child's Social Security number on your tax return.

7. State and Local Taxes. Before TCJA, individuals were permitted to claim the following types of taxes as itemized deductions, even if they were not business related: (1) state, local, and foreign real property taxes; (2) state and local personal property taxes; and (3) state, local, and foreign income, war profits, and excess profits taxes.

For tax years 2018 through 2025, TCJA limits the aggregate deduction for state and local real property taxes; state and local personal property taxes; state and local, and foreign, income, war profits, and excess profits taxes; and general sales taxes (if elected) for any tax year to $10,000 ($5,000 for marrieds filing separately). The $10,000 limit doesn't apply to: (i) foreign income, war profits, excess profits taxes; (ii) state and local, and foreign, real property taxes; and (iii) state and local personal property taxes if those taxes are paid or accrued in carrying on a trade or business or in an activity engaged in for the production of income.

8. Mortgage Interest. Under the pre-TCJA rules, you could deduct interest on up to a total of $1 million of mortgage debt used to acquire your principal residence and a second home, i.e., acquisition debt. For a married taxpayer filing separately, the limit was $500,000. You could also deduct interest on home equity debt, i.e., debt secured by the qualifying homes. Qualifying home equity debt was limited to the lesser of $100,000 ($50,000 for a married taxpayer filing separately), or the taxpayer's equity in the home or homes (the excess of the value of the home over the acquisition debt). The funds obtained via a home equity loan did not have to be used to acquire or improve the homes.

Under the TCJA, starting in 2018, the limit on qualifying acquisition debt is reduced to $750,000 ($375,000 for a married taxpayer filing separately). However, for acquisition debt incurred before December 15, 2017, the higher pre-TCJA limit applies. The higher pre-TCJA limit also applies to debt arising from refinancing pre-December 15, 2017 acquisition debt, to the extent the debt resulting from the refinancing does not exceed the original debt amount. This means you can refinance up to $1 million of pre-December 15, 2017 acquisition debt in the future and not be subject to the reduced limitation.

Starting in 2018, there is no longer a deduction for interest on home equity debt. This applies regardless of when the home equity debt was incurred.

In the absence of intervening legislation, the pre-TCJA rules come back into effect in 2026. So beginning in 2026, interest on home equity loans will be deductible again, and the limit on qualifying acquisition debt will be raised back to $1 million ($500,000 for married separate filers).

9. <u>Miscellaneous Itemized Deductions</u>. New §67(g) provides that there is no longer a deduction for miscellaneous itemized deductions, which were formerly deductible to the extent they exceeded 2 percent of adjusted gross income. This category of miscellaneous itemized deductions is extensive. Miscellaneous itemized deductions are all itemized deductions other than those specifically listed in §67(b). The excepted items, which are still deductible, include deductions for payment of interest, taxes, charitable contributions, medical expenses, and estate tax attributable to income in respect to a decedent. See Exhibit A.

Section 641(b) provides that the taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as provided in Subchapter J. Section 67(e) provides that, for purposes of §67, the adjusted gross income of an estate or trust shall be computed in the same manner as that of an individual, except that: (1) the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such estate or trust, and (2) the deductions allowable under §642(b), §651, and §661 shall be treated as allowable in arriving at adjusted gross income. Regulations, §1.67–4(a) states that §67(e) provides an exception to the 2-percent floor on miscellaneous itemized deductions for costs that are paid or incurred in the administration of an estate or a nongrantor trust and that would not have been incurred if the property were not held in such estate or trust. A cost is subject to the 2-percent floor to the extent that it is included in the definition of miscellaneous itemized deductions under §67(b), is incurred by an estate or non-grantor trust, and commonly or customarily would be incurred by a hypothetical individual holding the same property. Regulations, §1.67–4(c) provides that, subject to certain exceptions, if an estate or non-grantor trust pays a single fee, commission, or other expense for both costs that are subject to the 2-percent floor and costs that are not, then, the single fee, commission, or other expense (bundled fee) must be allocated, between the costs that are subject to the 2-percent floor and those that are not. Since executor and trustee fees are not specifically listed in §67(b), does TCJA preclude their deduction?

Section 642(b)(1) provides that on the termination of an estate or trust, a net operating loss or capital loss carryover is allowed as a deduction to the beneficiaries. Capital losses are not itemized deductions. Section 642(h)(2) provides that on termination of an estate or trust any deductions for the last taxable year of the estate or trust in excess of gross income shall be allowed as a deduction to the beneficiaries. This deduction is not mentioned in §67(b), and is a miscellaneous itemized deduction. Is this deduction allowed under TCJA?

Notice 2018-61 announces that the Treasury and the IRS intend to issue Regulations clarifying that estates and non-grantor trusts may continue to deduct expenses described in §67(e)(1) and amounts allowable as deductions under §642(b), §651 or §661, including the appropriate portion of a bundled fee, in determining the estate or non-grantor trust's adjusted gross income during taxable years. Additionally, the

Regulations will clarify that deductions enumerated in §67(b) and (e) continue to remain outside the definition of "miscellaneous itemized deductions" and thus are unaffected by §67(g). The Treasury and the IRS are aware of some concerns that the enactment of §67(g) will affect a beneficiary's ability to deduct §67(e) expenses upon the termination of the trust or estate as provided in §642(h). Section 642(h) provides that if, on the termination of an estate or trust, the trust or estate has: (1) a net operating loss carryover under §172 or a capital loss carryover under §1212, or (2) for the last taxable year of the estate or trust, deductions in excess of gross income for such year, then such carryover or such excess deductions shall be allowed as a deduction, to the beneficiaries succeeding to the property of the estate or trust. Regulations, §1.642(h)–1(b) provides, in part, that net operating loss carryovers and capital loss carryovers are taken into account when determining adjusted gross income. Therefore, they are above-the-line deductions and thus are not miscellaneous itemized deductions on the returns of beneficiaries. Conversely, Regs., §1.642(h)–2(a) provides that if, on the termination of an estate or trust, the estate or trust has for its last taxable year deductions in excess of gross income, the excess is allowed under §642(h)(2) as a deduction to the beneficiaries. However, the §642(h)(2) excess deduction is allowed only in computing the taxable income of the beneficiaries. Therefore, a §642(h)(2) excess deduction is not used in computing the beneficiaries' adjusted gross income and is treated as a miscellaneous itemized deduction of the beneficiaries. Miscellaneous itemized deductions are not permitted, and that appears to include the §642(h)(2) excess deduction. The Treasury and the IRS are studying whether §67(e) deductions, as well as other deductions that would not be subject to the limitations imposed by §67(a) and (g) in the hands of the trust or estate, should continue to be treated as miscellaneous itemized deductions when they are included as a §642(h)(2) excess deduction.

10. Medical Expenses. Under TCJA, for 2017 and 2018, medical expenses are deductible to the extent they exceed 7.5 percent of adjusted gross income for all taxpayers. Previously, the adjusted gross income "floor" was 10% for most taxpayers.

11. Casualty and Theft Losses. Before the TCJA, individuals could claim as itemized deductions certain personal casualty losses, not compensated by insurance or otherwise, including losses arising from fire, storm, shipwreck, or other casualty, or from theft. For tax years 2018 through 2025, the personal casualty and theft loss deduction isn't available, except for casualty losses incurred in a federally declared disaster. Where a taxpayer has personal casualty gains, personal casualty losses can still be offset against those gains, even if the losses aren't incurred in a federally declared disaster.

12. Overall Limitation on Itemized Deductions. The TCJA suspends the overall limitation ("Pease limitation") on itemized deductions that formerly applied to taxpayers whose adjusted gross income exceeded specific thresholds. The itemized deductions of such taxpayers were reduced by 3% of the amount by which AGI exceeded the applicable threshold, but the reduction could not exceed 80% of the total itemized deductions, and certain items were exempt from the limitation. Eliminating the Pease limitation may have little impact in light of the elimination of most itemized deductions.

13. Moving Expenses. The deduction for job-related moving expenses has been eliminated, except for certain military personnel. The exclusion for moving expense reimbursements has also been suspended.

14. Alimony. Under the current rules, an individual who pays alimony may deduct an amount equal to the alimony or separate maintenance payments paid during the year as an "above-the-line" deduction. An "above-the-line" deduction is a deduction that a taxpayer need not itemize deductions to claim, and is more valuable for the taxpayer than an itemized deduction. Under current rules, alimony and separate maintenance payments are taxable to the recipient spouse (includible in that spouse's gross income). Payers of child support don't get a deduction, and recipients of child support don't have to pay tax on those amounts.

Under the TCJA for divorces and legal separations that are executed (i.e., that come into legal existence due to a court order) after 2018, the alimony-paying spouse won't be able to deduct the payments, and the alimony-receiving spouse doesn't include them in gross income or pay federal income tax on them. The current rules continue to apply to already-existing divorces and separations, as well as divorces and separations that are executed *before 2019*. The current rules continue to apply to child support payments.

15. Health Care Individual Mandate. The TCJA has eliminated the shared responsibility payment, more commonly known as the "individual mandate," that penalizes individuals who are not covered by a health care plan, as outlined in the Affordable Care Act of 2010. This penalty is eliminated starting in 2019.

16. Alternative Minimum Tax (AMT). The TCJA doesn't repeal the AMT for individuals, but it does increase its exemption amounts for tax years 2018 through 2025, making it less likely to hit at lower income levels. Before the TCJA, individual AMT exemptions for 2018 (as adjusted for inflation) would have been $86,200 for marrieds filing jointly and surviving spouses; $55,400 for other unmarried individuals; and $43,100 for marrieds filing separately. Those exemption amounts would have been reduced by 25% of the amount by which the individual's alternative taxable income exceeded: $164,100 for marrieds filing jointly and surviving spouses (completely phased out at $508,900); $123,100 for unmarried individuals (completely phased out at $344,700); and $82,050 for marrieds filing separately (completely phased out at $254,450, with an additional add-back to discourage separate filing by marrieds).

The TCJA increases the individual AMT exemption amounts for tax years 2018 through 2025 to $109,400 for marrieds filing jointly and surviving spouses; $70,300 for single filers; and $54,700 for marrieds filing separately. These increased exemption amounts are reduced (not below zero) by 25% of the amount of the taxpayer's alternative taxable income above $1 million for joint returns and surviving spouses, and $500,000 for other taxpayers except estates and trusts. For trusts and estates, the base figure AMT exemption of $22,500, and phase-out threshold of $75,000, remain unchanged. All of these amounts will be indexed for inflation after 2018.

17. Recharacterization of IRA Contributions. An individual who makes a contribution to a regular or Roth IRA can recharacterize it as made to the other type of IRA via a trustee-to-trustee transfer before the due date of the return for the contribution year. Under the TCJA, once a contribution to a regular IRA has been converted into a contribution to a Roth IRA, it can no longer be converted back into a contribution to a regular IRA, i.e., a recharacterization cannot be used to "unwind" a Roth conversion.

18. Section 529 Plans. The TCJA has made some changes to §529 plans. These changes take effect for §529 plan distributions after 2017. A §529 plan distribution is tax-free if it is used to pay "qualified higher education expenses" of the beneficiary (student). The TCJA provides that qualified higher education expenses now include expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school. There is a limit to how much of a distribution can be taken from a §529 plan for these expenses. The amount of cash distributions from all §529 plans per single beneficiary during any tax year can't, when combined, include more than $10,000 for elementary school and secondary school tuition incurred during the tax year.

19. New Measure of Inflation. Under pre-TCJA law, the Code §1(f)(3) inflation adjustment computation was based on annual changes in the level of the Consumer Price Index for all Urban Consumers (i.e., the "CPI-U"), an index that measures prices paid by typical urban consumers on a broad range of products, developed and published by the Department of Labor. Effective for tax years beginning after 2017, the TCJA modifies the Code §1(f)(3) inflation adjustment computation rules to require use of chained CPI-U (i.e., "C-CPI-U"), instead of CPI-U, to index the income tax brackets for inflation. The C-CPI-U, like the CPI-U, is a measure of the average change over time in prices paid by urban consumers. But, the C-CPI-U differs from the CPI-U in that it accounts for the ability of individuals to alter their consumption patterns in response to relative price changes. The C-CPI-U reflects people's ability to lessen the impact of inflation by buying fewer goods or services that have risen in price and buying more goods and services whose price have risen less, or not at all. Thus, C-CPI-U is a slower-growing method of calculating COLAs. Using a lower rate of inflation to calculate future tax brackets means taxpayers may more quickly slip into the next higher tax bracket ("bracket creep"), and so will pay more in taxes over time.

Among the other provisions that are modified to require inflation adjustments be based on the C-CPI-U, instead of the CPI-U are:

1. Alternative minimum tax (AMT) for noncorporate taxpayers (individuals, estates and trusts), statutory dollar amounts in tentative minimum tax collection, AMT exemption amounts, and exemption phase-out thresholds. (Code §55(d)(4)(A(ii)).

2. Standard deduction. (Code §63(c)(4)(B)).

3. Overall limitation on itemized deductions, AGI phase-out amounts. (Code §68(b)(2)(B)).

4. Personal exemption deduction amount. (Code §151(d)(4)(B)).

5. Code §179 expensing dollar limit phase-out. (Code §179(b)(6)(A)(ii)).

6. Individual retirement account (IRA) deductible contribution limit and reduced limit for nonparticipant spouse of active participant. (Code §219(b)(5)(C)(i)(II); Code §219(g)(8)(B)).

7. Roth IRA dollar amounts for AGI limits (Code §408A(c)(3)(D)(ii)).

8. Applicable exclusion amount for unified credit against estate tax (Code §2010(c)(3)(B)(ii)).

9. Special use valuation, limitation on decrease in value of qualified real property (Code §2032A(a)(3)(B)).

10. Gift tax annual exclusion (Code §2503(b)(2)(B)).

11. Rate of interest on estate tax deferred under Code §6166, taxable value. (Code §6601(j)(3)(B)).

20. Kiddie Tax Modified. The tax on certain children with unearned income (the "kiddie tax") applies to the net unearned income of any child who: (i) is under age 19 by the close of the tax year, or is a full-time student under age 24; (ii) has at least one living parent at the close of the tax year; (iii) has unearned income of more than $2,100 (for 2017); and (iv) doesn't file a joint return. The kiddie tax applies regardless of whether the child may be claimed as a dependent by either or both parents. For children over age 17, the kiddie tax applies only to children whose earned income doesn't exceed one-half of the amount of their support.

Under the kiddie tax rules, children are taxed at the normally applicable rates on their earned income, and on their investment income ("unearned income") up to a prescribed amount (which is adjusted annually for inflation, $2,100 for 2017). For children who have more than the prescribed amount of unearned income for the tax year, that income is taxed to the child, but at the rate that would apply if that income were included in the parents' return, if that rate is higher than what the child would otherwise pay.

The TCJA modifies the kiddie tax to effectively apply the estates' and trusts' ordinary and capital gains rates to the net unearned income of a child. As under pre-TCJA law, the child's taxable income attributable to earned income is taxed according to an unmarried taxpayer's brackets and rates. Thus, under the TCJA changes, the child's tax will no longer be affected by the tax situation of the child's parent.

21. <u>Charitable Contribution Deduction Limitation Increased</u>. Under pre-TCJA law, an individual could take an itemized deduction up to 50% of the individual's contribution base (the "50% limit") for contributions to (as opposed to for the use of) 50% charities. These are charitable organizations such as (1) churches, (2) educational organizations, (3) foundations for the benefit of state colleges or universities, (4) hospitals and medical research organizations, (5) agricultural research organizations, (6) governmental bodies, (7) publicly supported organizations, (8) certain membership and other broadly supported organizations, (9) supporting organizations, and (10) certain private foundations. Charities that aren't 50% charities are 30% charities. Individuals may deduct up to 30% of their contribution bases (the "30% limit") for charitable contributions to or for the use of 30% charities and contributions for the use of 50% charities.

The TCJA increases the contribution-base percentage limit for tax years beginning after Dec. 31, 2017, and before Jan. 1, 2026, for deductions of *cash* contributions by individuals to 50% charities from 50% to 60%.

22. <u>No Deduction for Athletic Seating Rights</u>. Under pre-TCJA law, if a taxpayer made a payment to or for the benefit of a college or university that would have been allowable as a charitable deduction but for the fact that, as a result, the taxpayer received (directly or indirectly) the right to buy tickets for seating at an athletic event in the institution's athletic stadium, 80% of the payment was treated as a charitable contribution. Under the TCJA, no charitable deduction is allowed for a payment to a college or university in exchange for which the contributor receives the right to purchase tickets or seating at an athletic event.

23. <u>Self-Created Property Not a Capital Asset</u>. Under pre-TCJA law, certain self-created intangibles such as copyrights, literary, musical, or artistic compositions, letters or memoranda, or similar property were excluded from the definition of a capital asset if the asset is held either by the taxpayer who created the property, or (in the case of a letter, memorandum, or similar property) a taxpayer for whom the property was produced. Any self-created intangible that was excluded from the definition of a capital asset also was ineligible to be treated as a capital gain-ordinary loss asset (i.e., a trade or business asset) under Code §1231.

The TCJA excludes a patent, invention, model or design (whether or not patented), a secret formula or process, a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property which is held by the taxpayer who created the property from the definition of a capital asset.

II.

TCJA PROVISIONS THAT HAVE AN IMPACT ON BUSINESS. UNLESS OTHERWISE NOTED, THE CHANGES ARE EFFECTIVE FOR TAX YEARS BEGINNING IN 2018

24. <u>Corporate Tax Rates Reduced</u>. TCJA cuts the corporate tax rate to a flat 21%. Before the TCJA, rates were graduated, starting at 15% for taxable income up to $50,000, with rates at 25% for income between $50,001 and $75,000, 34% for income

between $75,001 and $10 million, and 35% for income above $10 million. Personal service corporations paid tax on their entire taxable income at the rate of 35%.

25. Dividends-Received Deduction. The dividends-received deduction available to corporations that receive dividends from other corporations has been reduced under the TCJA. For corporations owning at least 20% of the dividend-paying company, the dividends-received deduction has been reduced from 80% to 65% of the dividends. For corporations owning under 20%, the deduction is reduced from 70% to 50%.

26. Alternative Minimum Tax Repealed for Corporations. The corporate alternative minimum tax (AMT) has been repealed by TCJA.

27. Alternative Minimum Tax Credit. Corporations are allowed to offset their regular tax liability by the AMT credit. For tax years beginning after 2017 and before 2022, the credit is refundable in an amount equal to 50% (100% for years beginning in 2021) of the excess of the AMT credit for the year over the amount of the credit allowable for the year against regular tax liability. Thus, the full amount of the credit will be allowed in tax years beginning before 2022.

28. Net Operating Loss ("NOL") Deduction Modified. Under TJCA, generally, NOLs arising in tax years ending after 2017 can only be carried forward, not back. The general two-year carryback rule, and other special carryback provisions, have been repealed. However, a two-year carryback for certain farming losses is allowed. These NOLs can be carried forward indefinitely, rather than expiring after 20 years. Additionally, under the TCJA, for losses arising in tax years beginning after 2017, the NOL deduction is limited to 80% of taxable income, determined without regard to the deduction. Carryovers to other years are adjusted to take account of the 80% limitation.

29. Limit on Business Interest Deduction. Under the TCJA, every business, regardless of its form, is limited to a deduction for business interest equal to 30% of its adjusted taxable income. For pass-through entities such as partnerships and S corporations, the determination is made at the entity level. Adjusted taxable income is computed for tax years beginning after 2017 and before 2022, without regard to deductions for depreciation, amortization, or depletion. Any business interest disallowed under this rule is carried into the following year, and, generally, may be carried forward indefinitely. The limitation does not apply to taxpayers (other than tax shelters) with average annual gross receipts of $25 million or less for the three-year period ending with the prior tax year. Real property trades or businesses can elect to have the rule not apply if they elect to use the alternative depreciation system for real property used in their trade or business. Certain additional rules apply to partnerships.

30. New Fringe Benefit Rules. The TCJA eliminates the 50% deduction for business-related entertainment expenses. The pre-TCJA 50% limit on deductible business meals is expanded to cover meals provided via an in-house cafeteria or otherwise on the employer's premises. Additionally, the deduction for transportation fringe benefits (e.g., parking and mass transit) is denied to employers, but the exclusion from income for such benefits for employees continues. No deduction is allowed for transportation

expenses that are the equivalent of commuting for employees except as provided for the employee's safety.

31. Penalties and Fines. Under pre-TCJA law, deductions are not allowed for fines or penalties paid to a government for the violation of any law. Under the TCJA, no deduction is allowed for any otherwise deductible amount paid or incurred by suit, agreement, or otherwise to or at the direction of a government or specified nongovernmental entity in relation to the violation of any law or the investigation or inquiry by the government or entity into the potential violation of any law. An exception applies to any payment the taxpayer establishes is either restitution (including remediation of property), or an amount required to come into compliance with any law that was violated or involved in the investigation or inquiry, that is identified in the court order or settlement agreement as such a payment. An exception also applies to an amount paid or incurred as taxes due.

32. Sexual Harassment. Under the TCJA, effective for amounts paid or incurred after Dec. 22, 2017, no deduction is allowed for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if the payments are subject to a nondisclosure agreement.

33. Lobbying Expenses. The TCJA disallows deductions for lobbying expenses paid or incurred after the date of enactment with respect to lobbying expenses related to legislation before local governmental bodies.

34. Family and Medical Leave Credit. A new general business credit is available for tax years beginning in 2018 and 2019 for eligible employers equal to 12.5% of wages they pay to qualifying employees on family and medical leave if the rate of payment is 50% of wages normally paid to the employee. The credit increases by 0.25% (up to a maximum of 25%) for each percent by which the payment rate exceeds 50% of normal wages. For this purpose, the maximum leave that may be taken into account for any employee for any year is 12 weeks. Eligible employers are those with a written policy in place allowing qualifying full-time employees at least two weeks of paid family and medical leave a year, and less than full-time employees a pro-rated amount of leave. A qualifying employee is one who has been employed by the employer for one year or more, and who, in the preceding year, had compensation not above 60% of the compensation threshold for highly compensated employees. Paid leave provided as vacation leave, personal leave, or other medical or sick leave is not considered family and medical leave.

35. Qualified Rehabilitation Credit. The TCJA repeals the 10% credit for qualified rehabilitation expenditures for a building that was first placed in service before 1936, and modifies the 20% credit for qualified rehabilitation expenditures for a certified historic structure. The 20% credit is allowable during the five-year period starting with the year the building was placed in service in an amount that is equal to the ratable share for that year. This is 20% of the qualified rehabilitation expenditures for the building, as allocated ratably to each year in the five-year period. It is intended that the sum of the ratable shares for the five years not exceed 100% of the credit for qualified

rehabilitation expenditures for the building. The repeal of the 10% credit and modification of the 20% credit take effect starting in 2018 (subject to a transition rule for certain buildings owned or leased at all times after 2017).

36. Orphan Drug Credit Reduced and Modified. The TCJA reduces the business tax credit for qualified clinical testing expenses for certain drugs for rare diseases or conditions, generally known as "orphan drugs," from 50% to 25% of qualified clinical testing expenses for tax years beginning after 2017. These are costs incurred to test an orphan drug after it has been approved for human testing by the FDA but before it has been approved for sale. Amounts used in computing this credit are excluded from the computation of the separate research credit. The new law modifies the credit by allowing a taxpayer to elect to take a reduced orphan drug credit in lieu of reducing otherwise allowable deductions.

37. Increased Code §179 Expensing. Before the TCJA, most taxpayers could elect, on an asset-by-asset basis, to immediately deduct the entire cost of §179 property up to an annual limit of $500,000, adjusted for inflation. For assets placed in service in tax years that begin in 2018, the scheduled adjusted limit was $520,000. The annual limit was reduced by one dollar for every dollar that the cost of all §179 property placed in service by the taxpayer during the tax year exceeded a $2 million inflation-adjusted threshold. For assets placed in service in tax years that begin in 2018, the scheduled threshold was $2,070,000. The TCJA substitutes as the annual dollar limit $1 million (inflation-adjusted for tax years beginning *after* 2018) and $2.5 million as the phase down threshold (similarly inflation adjusted).

Before the TCJA, §179 property included tangible personal property as well as non-customized computer software. The only buildings or other non-production-process land improvements that qualified did so because the taxpayer elected to treat "qualified real property" as §179 property, for purposes of both the dollar limit and the phase down threshold. Qualified real property included restaurant buildings and certain improvements to leased space, retail space and restaurant space.

For tax years beginning after 2017, those buildings and improvements are eliminated as types of qualified real property and there is substituted a far broader group of improvements made to any building other than a residential rental building: (1) any building improvement other than elevators, escalators, building enlargements or changes to internal structural framework, and (2) building components that are roofs; heating, ventilation and air conditioning property; fire protection and alarm systems; or security systems. Also, for tax years beginning after 2017, items (for example, non-affixed appliances) used in connection with residential buildings (but not the buildings or improvements to them) are §179 property.

38. Bonus Depreciation. Before the TCJA, taxpayers were allowed to deduct in the year that an asset was placed in service 50% of the cost of most new tangible property other than buildings and, with the exception of qualified improvement property, building improvements. Most new computer software was also eligible for the 50% deduction. Because of the deduction in the year placed in service, there was adjustment

of the regular depreciation allowed in that year and later years. The "50% bonus depreciation" was to be phased down to 40% for property placed in service in calendar year 2018, 40% in 2019 and 0% in 2020 and afterward. The phase down was to begin a year later for certain private aircraft and long-production period property.

For property placed in service and acquired after September 27, 2017, the TCJA has raised the 50% rate to 100%, i.e. "full expensing" or "100% expensing". Additionally, under the TCJA, the post-September 27, 2017 property eligible for bonus depreciation can be new *or used*. Also, certain film, television and live theatrical productions are now eligible. The TCJA excluded from bonus depreciation public utility property and property owned by certain vehicle dealerships.

The 2018/2019/2020 phase down (above) doesn't apply to post-September 27, 2017 property. Instead, 100% depreciation is decreased to 80% for property placed in service in calendar year 2023, 60% in 2024, 40% in 2025, 20% in 2026, and 0% in 2027 and afterward (with phase down beginning a year later for certain private aircraft and long-production period property).

39. Depreciation of Qualified Improvement Property. If placed in service after 2017, TCJA provides that qualified improvement property, in addition to being eligible for bonus depreciation and being newly eligible as §179 property, is depreciable using a 15-year recovery period and the straight-line method. Qualified improvement property is any improvement to an interior portion of a building that is nonresidential real property placed in service after the building was placed in service. It does not include expenses related to the enlargement of the building, any elevator or escalator, or the internal structural framework. There are no longer separate requirements for leasehold improvement property or restaurant property.

40. Depreciation of Farming Equipment and Machinery. Under the TCJA, subject to certain exceptions, the cost recovery period for farming equipment and machinery, the original use of which begins with the taxpayer, is reduced from 7 to 5 years. Additionally, in general, the 200% declining balance method may be used in place of the 150% declining balance method that was required under pre-TCJA law.

41. Luxury Auto Depreciation Limits. Under the TCJA, for a passenger automobile for which bonus depreciation is not claimed, the maximum depreciation allowance is increased to $10,000 for the year it's placed in service, $16,000 for the second year, $9,000 for the third year, and $5,760 for the fourth and later years in the recovery period. These amounts are indexed for inflation after 2018. For passenger autos eligible for bonus first year depreciation, the maximum additional first year depreciation allowance remains at $8,000 as under pre-TCJA law.

42. Computers and Peripheral Equipment. The TCJA removes computers and peripheral equipment from the definition of listed property. Thus, the heightened substantiation requirements and possibly slower cost recovery for listed property no longer apply.

43. New Rules for Post-2021 Research and Experimentation ("R & E") Expenses. Under the TCJA, specified R & E expenses paid or incurred after 2021 in connection with a trade or business must be capitalized and amortized ratably over a 5-year period (15 years if conducted outside the U.S.). These include expenses for software development, but not expenses for land, or depreciable or depletable property used in connection with the R & E (but do include the depreciation and depletion allowance for such property). For R&E expenses paid or incurred before 2022, these expenses are deductible currently or may be capitalized and recovered over the useful life of the research (not to exceed 60 months), or over a ten-year period, at the taxpayer's election.

44. Like-kind Exchange Treatment Limited. In a like-kind exchange, a taxpayer doesn't recognize gain or loss on an exchange of like-kind properties if both the relinquished property and the replacement property are held for productive use in a trade or business or for investment purposes. For exchanges completed after Dec. 31, 2017, the TCJA limits tax-free exchanges to exchanges of real property that is not held primarily for sale. Thus, exchanges of personal property and intangible property can't qualify as tax-free like-kind exchanges. Although the real property limitation applies to exchanges completed after Dec. 31, 2017, transition rules provide relief for certain exchanges.

45. Excessive Employee Compensation. Under pre-TCJA law, a deduction for compensation paid or accrued with respect to a covered employee of a publicly traded corporation is deductible only up to $1 million per year. Exceptions applied for commissions, performance-based pay, including stock options, payments to a qualified retirement plan, and amounts excludable from the employee's gross income. The TCJA repealed the exceptions for commissions and performance-based pay. The definition of "covered employee" is revised to include the principal executive officer, principal financial officer, and the three highest-paid officers. An individual who is a covered employee for a tax year beginning after 2016 remains a covered employee for all future years.

46. Employee Achievement Awards Clarified. An employee achievement award is tax free to the extent the employer can deduct its cost, generally limited to $400 for one employee or $1,600 for a qualified plan award. An employee achievement award is an item of tangible personal property given to an employee in recognition of length of service or a safety achievement and presented as part of a meaningful presentation. The TCJA defines "tangible personal property" to exclude cash, cash equivalents, gift cards, gift coupons, gift certificates (other than from an employer pre-selected limited list), vacations, meals, lodging, theater or sports tickets, stocks, bonds, or similar items, and other non-tangible personal property.

47. Cash Basis Accounting and Income Inclusion Reporting. TCJA includes a number of changes to the rules governing the choice of accounting methods by taxpayers. In certain situations, the Act raises the gross receipts limit used to determine which taxpayers can use the cash method of accounting.

The TCJA provides that, for tax years beginning after December 31, 2017, taxpayers that have average annual gross receipts of *$25 million* or less during the preceding three years (up from $10 million under pre-TCJA law) aren't required to account for the cost of goods sold using inventories under Code §471 (and, thus, aren't required to use the accrual method of accounting); but rather may use a method of accounting for inventories that either: (1) treats inventories as non-incidental materials and supplies, or (2) conforms to the taxpayer's financial accounting treatment of inventories.

The TCJA provides that, in tax years beginning after December 31, 2017, a farming business owned by a C corporation (or partnerships with such a C corporation as a partner) is exempt from the rule requiring such corporations to use the accrual method if the corporation meets an inflation-adjusted *$25 million* gross receipts test for the tax year. This limit replaces both the non-inflation-adjusted $25 million limit for family corporations and the $1 million limit for non-family corporations in effect before the TCJA.

The TCJA requires (or allows) taxpayers in certain circumstances to recognize income for tax purposes no later than the year in which it's recognized for financial reporting purposes.

The TCJA provides that, for an accrual basis taxpayer, the all events test with respect to any item of gross income (or portion thereof) in tax years beginning after December 31, 2017, won't be treated as met any later than (and, thus, these taxpayers must recognize income no later than) the tax year in which the income is taken into account as income on (1) an applicable financial statement or (2) under rules specified by IRS, another financial statement.

The TCJA allows taxpayers in tax years beginning after December 31, 2017, to defer the inclusion of income associated with certain advance payments to the end of the tax year following the tax year of receipt if that income also is deferred for financial statement purposes.

III.

TCJA PROVISIONS THAT HAVE AN IMPACT ON PARTNERSHIPS, S CORPORATIONS, AND PASS-THROUGH INCOME. IN GENERAL, THEY ARE EFFECTIVE STARTING IN 2018

48. <u>New Deduction For Pass-Through Income</u>. TCJA adds new §199A establishing a new tax deduction taking effect in 2018 with respect to "qualified business income" from a partnership, S corporation, LLC, or sole proprietorship. This income is sometimes referred to as "pass-through" income. As with most individual tax changes in TCJA, §199A is effective for taxable years from 2018 through 2025.

The deduction is 20% of your "qualified business income" (QBI) from a partnership, S corporation, or sole proprietorship, defined as the net amount of items of income, gain, deduction, and loss with respect to your trade or business. The business must be conducted within the U.S. to qualify, and specified investment-related items are not included, e.g., capital gains or losses, dividends, and interest income (unless the interest is properly allocable to the business). The trade or business of being an employee does not qualify. Also, QBI does not include reasonable compensation received from an S corporation, or a guaranteed payment received from a partnership for services provided to a partnership's business.

TCJA amends §63 to add new §63(b)(3) dealing with the deduction provided in §199A. Accordingly, the deduction is taken "below the line," i.e., it reduces your taxable income but not your adjusted gross income. It is available regardless of whether you itemize deductions or take the standard deduction. In general, the deduction cannot exceed 20% of the excess of your taxable income over net capital gain. If QBI is less than zero, it is treated as a loss from a qualified business in the following year.

For taxpayers with taxable income in 2018 above the Threshold Amount, i.e. $157,500 ($315,000 for joint filers), an exclusion from QBI of income from a Specified Service Trade or Business is phased in. These are trades or businesses involving the performance of services in the fields of health, law, consulting, athletics, financial or brokerage services, or where the principal asset is the reputation or skill of one or more employees or owners. Additionally, for taxpayers with taxable income more than the Threshold Amount, a limitation on the amount of the deduction is phased in based either on W-2 Wages paid; or W-2 Wages paid plus a capital element, i.e. UBIA of qualified property.

Other limitations may apply in certain circumstances, e.g., for taxpayers with qualified cooperative dividends, qualified real estate investment trust (REIT) dividends, or income from publicly traded partnerships.

The deduction under §199A reduces the discrepancy in the top rates (21% - 37%) at which business income would be taxed depending on whether the business is taxed as a C corporation or as a pass-through entity. Generally, the §199A deduction results in a top rate of 29.6% for taxation of qualified business income from pass-through entities: $(1 - 0.20) \times 37\% = 29.6\%$.

The IRS estimates that 22 to 24 million taxpayers will be eligible for the §199A deduction, and that 95% of those eligible taxpayers will fall below the Threshold Amount and will not be subject to the W-2 Wages or UBIA of qualified property limitation, or the Specified Service Trade or Business restriction.

The IRS on August 8, 2018 issued 184 pages of Proposed Regulations (including a 104 page preamble to §199A and the multiple trust rule under §643). Some of the Proposed Regulations have been controversial and all of them are complicated.

On January 18, 2019, the IRS released the final §199A Regulations.

Rev. Proc. 2019-11 provides three methods of calculating W-2 wages. The first method is more simplified whereas the other two methods are more complicated, but may provide greater accuracy.

Notice 2019-7 provides a safe harbor respecting when rental real estate qualifies as a trade or business for purposes of §199A. The safe harbor would have three conditions: (i) maintenance of separate books and records; (ii) at least 250 hours spent on an annual basis; and (iii) contemporaneous record-keeping.

See Exhibit B.

49. S Corporation Conversion to C Corporation. Under the TCJA, on the date of its enactment, any §481(a) adjustment of an "eligible terminated S corporation" attributable to the revocation of its S corporation election (i.e., a change from the cash method to the accrual method) is taken into account ratably during the 6-tax-year period starting with the year of change. An "eligible terminated S corporation" is any regular C corporation which meets the following tests: (1) it was an S corporation the day before the enactment of the TCJA, (2) during the 2-year period beginning on the date of enactment it revokes its S corporation election, and (3) all of the owners on the date the election is revoked are the same owners (in identical proportions) as the owners on the date of enactment. If money is distributed by the eligible corporation after the post-termination transition period, the distribution will be allocated between the accumulated adjustment account and the accumulated earnings and profits, in the same ratio as the amount in the accumulated adjustments account bears to the amount of the accumulated earnings and profits.

50. Partnership "Technical Termination" Rule Repealed. Before the TCJA, partnerships experienced a "technical termination" if, within any 12-month period, there was a sale or exchange of at least 50% of the total interest in partnership capital and profits. This resulted in a deemed contribution of all partnership assets and liabilities to a new partnership in exchange for an interest in it, followed by a deemed distribution of interests in the new partnership to the purchasing partners and continuing partners from the terminated partnership. Some of the tax attributes of the old partnership terminated, its tax year closed, partnership-level elections ceased to apply, and depreciation recovery periods restarted. This often imposed unintended burdens and costs on the parties. The TCJA repeals this rule. A partnership termination is no longer triggered if within a 12-month period, there is a sale or exchange of 50% or more of total partnership capital and profits interests. A partnership termination will still occur 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.

51. Partnership Loss Limitation Rule. A partner can only deduct his share of partnership loss to the extent of his basis in his partnership interest as of the end of the partnership tax year in which the loss occurred. IRS has ruled that this loss limitation rule should not apply to limit a partner's deduction for his share of partnership charitable contributions. The TCJA provides that the rule limiting a partner's losses to his basis in his partnership interest is applied by reducing his basis by his share of partnership charitable contributions. However, in the case of partnership charitable contributions of property with a fair market value that exceeds its adjusted basis, the partner's basis reduction is limited to his share of the basis of the contributed property.

52. Carried Interest – New Holding Period. A profits interest in a partnership is any interest other than a capital interest. A profits interest gives the holder the right to receive future profits and appreciation in value of assets of a partnership, but doesn't give the holder a share of the proceeds upon the immediate liquidation of the partnership. The receipt of a capital interest for services provided to a partnership results in taxable compensation for the recipient. Under a safe harbor rule, the receipt of a profits interest in exchange for services provided is not a taxable event to the recipient if the profits interest entitles the holder to share only in gains and profits generated after the date of issuance (and certain other requirements are met).

Partnerships can issue profits interests to key service providers because they aren't taxable at grant, but the holder of the profits interest will be considered to be a partner from the time of vesting and will be eligible for long-term capital gain treatment upon a liquidity event *if the relevant holding period is met*. Profits interests are commonly used in private investment funds and are often referred to as "carried interest". In this context, carried interest is a share of the profits that the general partner (commonly a manager of a private equity fund, hedge fund, or similar investment vehicle) receives as compensation, regardless of that partner's capital investment, if any. A partnership is required to compute certain classes of income and deductions as separate items. These classes of income and deductions are then directly "passed through" to the partners, who take them into account for tax purposes by including their distributive share of each of these classes of income and deductions as separate items on their tax returns. In the hands of the partner, the character of any partnership item that must be "separately stated" is determined as if realized directly from the source from which the partnership realized it, or incurred in the same manner as the partnership incurred it. Thus, to determine the nature of an item of separately stated income, gain, loss, deduction or credit in the hands of the partnership and in the hands of the partner, the partnership is viewed as an entity, and the items are characterized from the viewpoint of the partnership rather than from the viewpoint of an individual partner. If a partnership recognizes gain from the sale of a capital asset that it has held for more than one year, an individual partner who is allocated a share of the partnership's long-term capital gain will be taxed on that share at long-term capital gain rates.

This was the crux of the perceived windfall that fund managers derived from carried interest. Outside of the partnership context, individuals typically are taxed at favorable capital gain rates only on gains generated from investments of their after-tax dollars. However, as a result of the partnership tax regime, carried interest passed through the partnership as long-term capital gain and fund managers were able to pay tax at a more favorable rate on gains derived from their services, which would have been ordinary income had it been paid as compensation for their services.

The TCJA changes the tax treatment of gains from a profits interest in a partnership held in connection with the performance of services by providing 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. Section 83, relating to property transferred in connection with the performance of services, doesn't apply to the transfer of a partnership interest to which this provision applies.

IV.

TCJA PROVISIONS THAT HAVE AN IMPACT ON TAX-EXEMPT ORGANIZATIONS. IN GENERAL, THE PROVISIONS INVOLVED ARE EFFECTIVE STARTING IN 2018

53. Excise Tax on Exempt Organization's Excessive Compensation. Before the TCJA, executive compensation paid by tax-exempt entities was subject to reasonableness requirements and a prohibition against private inurement. The TCJA adds an excise tax that is imposed on compensation in excess of $1 million paid by an exempt organization to a "covered" employee. The tax rate is set at 21%, which is the new corporate tax rate. Compensation for these purposes is the sum of: (1) remuneration (other than an excess parachute payment) over $1 million paid to a covered employee by a tax-exempt organization for a tax year; plus (2) any excess parachute payment paid by the organization to a covered employee. A covered employee is an employee or former employee of the organization who is one of its five highest compensated employees for the tax year, or was a covered employee of the organization or its predecessor for any preceding tax year beginning after 2016. Remuneration is treated as paid when there is no substantial risk of forfeiture of the rights to the remuneration.

54. Excise Tax on Private College's Investment Income. Before the new law, private colleges and universities were generally treated as public charities, as opposed to private foundations, and were therefore not subject to the private foundation excise tax on their net investment income. The new law imposes an excise tax on the net investment income of colleges and universities meeting specified size and asset requirements. The excise tax rate is 1.4% of the institution's net investment income, and applies only to private colleges and universities with at least 500 students, more than half of whom are in the U.S., and with assets of at least $500,000 per student. For this purpose, assets used directly in carrying out the institution's exempt purpose are not counted. The number of students is based on a daily average of "full-time equivalent" students, i.e., two students carrying half loads would count as a single full-time equivalent student. For purposes of the excise tax, net investment income is the institution's gross investment income minus expenses incurred to produce it, but without the use of accelerated depreciation or percentage depletion.

55. Exempt Organization's UBTI Computed Separately for Separate Businesses. Before the TCJA, a tax-exempt organization computed its unrelated business taxable income (UBTI) by subtracting deductions directly connected with the unrelated trade or business from its gross income from the unrelated trade or business. If the organization had more than one unrelated trade or business, the organization combined its income and deductions from all of the trades or businesses. Under that approach, a loss from one trade or business could offset income from another unrelated trade or business, thus reducing overall UBTI. Under the TCJA, an exempt organization cannot use losses from one unrelated trade or business to offset income from another one. Gains and losses are calculated and applied to each unrelated trade or business separately. There is an exception for net operating losses from pre-2018 tax years that are carried forward.

56. Exempt Organization's UBTI to Include Disallowed Fringe Benefit Costs. Under the TCJA, an exempt organization's unrelated business taxable income (UBTI) is to include any nondeductible entertainment expenses, and costs incurred for any qualified transportation fringe, parking facility used in connection with qualified parking, or any on-premises athletic facility. However, UBTI is not to include any such amount to the extent it is directly connected with an unrelated trade or business regularly carried on by the organization.

V.

TCJA PROVISIONS THAT HAVE AN IMPACT ON TRANSFER TAX

57. Applicable Credit Amount; GST Exemption Amount. Before the TCJA, the first $5 million (as adjusted for inflation in years after 2011) of transferred property was exempt from estate tax, gift tax, and generation-skipping tax. For estates of decedents dying and gifts made in 2018, this “basic exclusion amount” as adjusted for inflation, would have been $5,600,000.00, or $11,200,000.00 for a married couple. With proper planning, the unused portion of a deceased spouse's exclusion amount (DSUEA) could be added to that of the surviving spouse (“portability”) for purposes of the estate tax and gift tax.

For decedents dying and gifts made from 2018 through 2025, the TCJA doubles the base estate and gift tax exemption amount from $5 million to $10 million. Indexing for post-2011 inflation, and considering C-CPI-U adjustment for tax years beginning after 2017, brings this amount to $11,180,000.00 for 2018, and $22,360,000.00 million per married couple, with the same basic portability techniques. The TCJA doesn't specifically mention the generation-skipping tax (GST), but since the GST exemption amount is based on the basic exclusion amount, the GST exemption amount is similarly adjusted. The basic exclusion amount for 2019 is $11,400,000.00, and $22,800,000.00 per married couple.

58. Clawback. TCJA amends §2001(g) to add new §2001(g)(2) directing the Treasury to prescribe regulations necessary to address any difference in the basic exclusion amount at the time of a gift and at the time of death. This is to deal with the possibility of a “clawback” of a prior gift. A clawback would occur with respect to a prior gift that was covered by the gift tax exclusion at the time of the gift, but results in estate tax because the estate tax exclusion has decreased at the time of the donor's death. This was an issue in 2012 when there was a possibility that the gift tax exclusion could be reduced from $5 million to $1 million.

Proposed Regulations were released on November 20, 2018, dealing with the clawback issue. The Proposed Regulations deal specifically with the issue addressed in §2001(g)(2). The Proposed Regulations would amend §20.2010-1 to ensure that a decedent's estate is not inappropriately taxed with respect to gifts made during the increased basic exclusion amount period.

See Exhibit C.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

6. Repeal of Certain Miscellaneous Itemized Deductions Subject to the Two-Percent Floor (secs. 1307 and 1312 of the House bill, sec. 11045 of the Senate amendment, and secs. 62, 67 and 212 of the Code)

PRESENT LAW

Individuals may claim itemized deductions for certain miscellaneous expenses. Certain of these expenses are not deductible unless, in aggregate, they exceed two percent of the taxpayer's adjusted gross income ("AGI").[222] The deductions described below are subject to the aggregate two-percent floor.[223]

Expenses for the production or collection of income

Individuals may deduct all ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income.[224]

Present law and IRS guidance provide examples of items that may be deducted under this provision. This non-exhaustive list includes:[225]

- Appraisal fees for a casualty loss or charitable contribution;
- Casualty and theft losses from property used in performing services as an employee;
- Clerical help and office rent in caring for investments;
- Depreciation on home computers used for investments;
- Excess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust;
- Fees to collect interest and dividends;
- Hobby expenses, but generally not more than hobby income;
- Indirect miscellaneous deductions from pass-through entities;
- Investment fees and expenses;
- Loss on deposits in an insolvent or bankrupt financial institution;
- Loss on traditional IRAs or Roth IRAs, when all amounts have been distributed;
- Repayments of income;
- Safe deposit box rental fees, except for storing jewelry and other personal effects;
- Service charges on dividend reinvestment plans; and
- Trustee's fees for an IRA, if separately billed and paid.

Tax preparation expenses

For regular income tax purposes, individuals are allowed an itemized deduction for expenses for the production of income. These expenses are defined as ordinary and necessary expenses paid or incurred in a taxable year: (1) for the production or collection of income; (2) for the management, conservation, or maintenance of property held for the production of income; or (3) in connection with the determination, collection, or refund of any tax.[226]

Unreimbursed expenses attributable to the trade or business of being an employee

In general, unreimbursed business expenses incurred by an employee are deductible, but only as an itemized deduction and

[222] Sec. 67(a).
[223] The miscellaneous itemized deduction for tax preparation expenses is described in a separate section of this document.
[224] Sec. 212(1).
[225] See IRS Publication 529, *"Miscellaneous Deductions"* (2016), p. 9.
[226] Sec. 212.

only to the extent the expenses exceed two percent of adjusted gross income.[227]

Present law and IRS guidance provide examples of items that may be deducted under this provision. This non-exhaustive list includes:[228]

- Business bad debt of an employee;
- Business liability insurance premiums;
- Damages paid to a former employer for breach of an employment contract;
- Depreciation on a computer a taxpayer's employer requires him to use in his work;
- Dues to a chamber of commerce if membership helps the taxpayer perform his job;
- Dues to professional societies;
- Educator expenses;[229]
- Home office or part of a taxpayer's home used regularly and exclusively in the taxpayer's work;
- Job search expenses in the taxpayer's present occupation;
- Laboratory breakage fees;
- Legal fees related to the taxpayer's job;
- Licenses and regulatory fees;
- Malpractice insurance premiums;
- Medical examinations required by an employer;
- Occupational taxes;
- Passport fees for a business trip;
- Repayment of an income aid payment received under an employer's plan;
- Research expenses of a college professor;
- Rural mail carriers' vehicle expenses;
- Subscriptions to professional journals and trade magazines related to the taxpayer's work;
- Tools and supplies used in the taxpayer's work;
- Purchase of travel, transportation, meals, entertainment, gifts, and local lodging related to the taxpayer's work;
- Union dues and expenses;
- Work clothes and uniforms if required and not suitable for everyday use; and
- Work-related education.

Other miscellaneous itemized deductions subject to the two-percent floor

Other miscellaneous itemized deductions subject to the two-percent floor include:

- Repayments of income received under a claim of right (only subject to the two-percent floor if less than $3,000);
- Repayments of Social Security benefits; and
- The share of deductible investment expenses from pass-through entities.

[227] Secs. 62(a)(1) and 67.
[228] See IRS Publication 529, *"Miscellaneous Deductions"* (2016), p. 3.
[229] Under a special provision, these expenses are deductible "above the line" up to $250.

EXHIBIT B

Section 199A Deduction
Definitions

1. Section 199A Deduction: Section 199A applies to taxable years beginning in 2018 and ending in 2025. Section 199A provides a deduction of up to 20% of income from a domestic (U.S.) business operated as a sole proprietorship, partnership, S corporation, trust, or estate. The §199A deduction may be taken by individuals and by some estates and trusts. A §199A deduction is not available for wage income or for business income earned through a C corporation. The §199A deduction is applied at the partner or shareholder level and does not affect the adjusted basis of a partner's interest in a partnership, the adjusted basis of a shareholder's stock in an S corporation, or an S corporation's accumulated adjustments account.

2. Qualified Trade or Business: An IRC, §162 trade or business other than the trade or business of performing services as an employee. Rental or licensing of tangible or intangible property (rental activity) that does not rise to the level of a business may qualify. The §199A deduction is not based on the level of a taxpayer's involvement in the trade or business. That is, both active and passive owners of a trade or business may be entitled to the §199A deduction.

3. Aggregated Trade or Business: Two or more qualified trades or businesses that have been aggregated pursuant to the Regulations. Aggregation is permitted but is not required. An individual may aggregate trade or businesses operated directly and the individual's share of QBI, W-2 Wages, and UBIA of qualified property from trades or businesses operated through RPE's. Multiple owners of an RPE need not aggregate in the same manner.

4. Qualified Business Income (QBI): For any taxable year, the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer. QBI does not include capital gain or loss, dividends, interest income, or reasonable compensation paid to the taxpayer. If an individual has multiple trades or businesses, the individual must calculate the QBI from each trade or business and then net the amounts.

5. Total QBI Amount: The net total QBI from all trades or businesses (including the individual's share of QBI from trades or businesses conducted by RPE's).

6. Relevant Passthrough Entity (RPE): A partnership (other than a PTP) or an S Corporation that is owned, directly or indirectly, by at least one individual, estate, or trust. A trust or estate is treated as an RPE to the extent it passes through QBI, W-2 Wages, UBIA of qualified property, qualified REIT dividends, or qualified PTP income. RPE's must compute QBI, W-2 Wages, and UBIA of qualified property for each trade or business for their owners to determine their §199A deduction.

7. Individual: An individual, trust, estate, or other person eligible to claim the §199A deduction.

8. Allocable Share: Generally equivalent to the partner's allocable share of partnership items or the shareholder's pro rata share of S corporation items.

9. W-2 Wages: A qualified trade or business's W-2 wages properly allocable to QBI. The W-2 Wage limitation applies separately for each trade or business. Notice 2018-64 released a proposed Revenue Procedure addressing alternative methods for calculating W-2 Wages.

10. Qualified Property: Tangible property subject to the allowance for depreciation, held by the qualified trade or business at the close of the taxable year, and which is used in the production of QBI and for which the depreciation period has not ended before the close of the taxable year. Depreciation period is the period beginning on the date the property was first placed in service and ending on the later of: (i) 10 years after such date; or (ii) the last full year in the applicable recovery period.

11. Unadjusted Basis Immediately After Acquisition of Qualified Property (UBIA of Qualified Property): Is generally the cost basis of the qualified property as of the date the property is placed in service, unadjusted by depreciation.

12. Specified Service Trade or Business (SSTB): Any trade or business involving the performance of services in one or more of the following fields: health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, investing, investment management, trading, dealing in securities, or a business where the principal asset is the reputation or skill of its employees or owners. If the individual's taxable income exceeds the phase-in range, then none of the individual's share of QBI, W-2 Wages, or UBIA of qualified property attributable to an SSTB may be taken into account for purposes of determining the individual's §199A deduction. However, the SSTB limitation does not apply to individuals with taxable income below the threshold amount.

13. Threshold Amount: For 2018, $157,500; or $315,000 for a joint return; indexed with inflation. For 2019, $321,400 for married filing joint returns; $160,725 for married filing separate returns; and $160,700 for single and head of household returns, trusts and estates. The threshold amount is taxable income calculated after allowable deductions or the standard deduction.

14. Phase-In Amount: $50,000; or $100,000 for a joint return.

15. Phase-In Range: For 2018, between $157,500 and $207,500; or between $315,000 and $415,000 for a joint return. For 2019, between $160,700 and $210,700; or between $321,400 and $421,400 for a joint return.

16. Phase-In Ratio:

$$\frac{\text{Taxable Income in Excess of Threshold Amount}}{\text{Phase-In Amount}}$$

17. Applicable Percentage: 100% less the Phase-In Ratio.

18. Excess Amount: The amount by which 20% of QBI exceeds the greater of:
(i) 50% of W-2 Wages; or
(ii) 25% of W-2 Wages, plus 2.5% of UBIA of qualified property.

19. Reduction Amount: Excess Amount times the Phase-In Ratio.

20. REIT: A Real Estate Investment Trust.

21. QPTP: A Qualified Publicly Traded Partnership.

22. Trusts and Estates: A non-grantor trust or estate computes its §199A deduction based on the QBI, W-2 Wages, and UBIA of qualified property that are allocated to the trust or estate. An individual beneficiary of a trust or estate takes into account any QBI, W-2 Wages, UBIA of qualified property allocated from a trust or estate in calculating the beneficiary's §199A deduction, in the same manner as though the items had been allocated from an RPE. A trust or estate is treated as an RPE to the extent it allocates QBI and other items to its beneficiaries, and is treated as an individual to the extent it retains the QBI and other items. In the case of a non-grantor trust or estate, the QBI and expenses properly allocable to the business, including W-2 Wages and UBIA of qualified property must be allocated among the trust or estate and its beneficiaries. The allocation is based on the ratio of the trust's or estate's DNI that is distributed or deemed to be distributed to the beneficiaries bears to the trust's or estate's total DNI for the taxable year. Any DNI not distributed is allocated to the trust or estate itself.

23. Multiple Trusts: If multiple trusts have substantially the same grantors and beneficiaries, and a principal purpose for establishing such trusts or contributing additional cash or other property to such trusts is the avoidance of Federal income tax, then the various trusts will be generally considered one trust, including for §199A purposes.

24. Negative QBI Amount: If the total QBI amount is less than zero, the portion of the individual's §199A deduction related to QBI is zero for the taxable year. The negative total QBI amount is treated as negative QBI from a separate trade or business in the succeeding taxable year of the individual for purposes of §199A. This carryover rule does not affect the deductibility of the loss for purposes of other Code provisions.

25. W-2 Wages or UBIA Limitation: The greater of the individual's allocable share of:
(i) 50% of W-2 Wages for that trade or business; or
(ii) 25% of W-2 Wages for that trade or business, plus 2.5% of UBIA of qualified property for that trade or business.

26. <u>QBI Component</u>: The sum of the following for each separate trade or business – the lesser of:
(i) 20% of QBI for that trade or business; or
(ii) W-2 Wages or UBIA Limitation for that trade or business.

Section 199A Deduction
General Rules

I.

For individuals not exceeding the Threshold Amount, and with no REIT dividends and no QPTP income, the §199A Deduction is 20% of the individual's allocable share of QBI with respect to each Qualified Trade or Business (including QBI attributable to an SSTB).

However, the §199A Deduction cannot exceed 20% of the individual's ordinary taxable income (taxable income – net capital gain).

The Threshold Amount for 2019 is: (i) $321,400 for married filing joint returns; (ii) $160,725 for married filing separate returns; and (iii) $160,700 for single and head of household returns, trusts and estates.

II.

For individuals exceeding the Threshold Amount by the Phase-In Amount, and with no REIT Dividends and no QPTP income, the §199A Deduction is the lesser of:

1) 20% of the individual's allocable share of QBI with respect to each Qualified Trade or Business; or
2) The W-2 Wage and UBIA of qualified property limitations.

The Phase-In Amount is $50,000, or $100,000 in the case of a joint return ($160,700 + $50,000 = $210,700; $321,400 + $100,000 = $421,400).

The W-2 Wage and UBIA of qualified property limitations are the greater of:

(i) 50% of the individual's allocable share of W-2 Wages with respect to the Qualified Trade or Business; or

(ii) The sum of 25% of the individual's allocable share of W-2 Wages with respect to the Qualified Trade or Business; plus 2.5% of the individual's allocable share of unadjusted basis immediately after acquisition (UBIA) of all qualified property.

However, the §199A Deduction cannot exceed 20% of the individual's ordinary taxable income (taxable income – net capital gain).

III.

For individuals exceeding the Threshold Amount by less than the Phase-In Amount, and with no REIT Dividends and no QPTP income, the §199A Deduction is equal to:

1) 20% of the individual's allocable share of QBI with respect to each Qualified Trade or Business; less
2) The Reduction Amount.

The Reduction Amount is the Excess Amount times the Phase-In Ratio.

The Excess Amount is the amount by which:

(i) 20% of the individual's allocable share of QBI with respect to each Qualified Trade or Business; exceeds

(ii) The W-2 Wage and UBIA of qualified property limitations.

The Phase-In Ratio is that fraction, the numerator of which is the amount by which the individual's taxable income for the taxable year exceeds the Threshold Amount, and the denominator of which is the Phase-In Amount. (i.e. the percentage the individual is "through" the phase-in range).

However, the §199A Deduction cannot exceed 20% of the individual's ordinary taxable income (taxable income – net capital gain).

IV.

For individuals not exceeding the Threshold Amount, a Specified Service Trade or Business (SSTB) is a Qualified Trade or Business. Therefore, income from the SSTB is Qualified Business Income.

V.

For individuals exceeding the Threshold Amount by the Phase-In Amount, an SSTB is not a Qualified Trade or Business. Therefore, income from the SSTB is not Qualified Business Income.

VI.

For individuals exceeding the Threshold Amount by less than the Phase-In Amount, only the applicable percentage of qualified items of income, gain, deduction or loss and the W-2 Wage and UBIA of qualified property of the individual allocable to such SSTB shall be taken into account. These reduced numbers must then be used to determine how the individual's §199A Deduction is limited.

The Applicable Percentage is equal to:

(i) 100%; less

(ii) The Phase-In Ratio.

Exhibit C
Clawback

In 2018, I have an Old Exclusion Amount of $5,590,000.00. I have a Trump Exclusion Amount of $5,590,000.00. Combined, I have a Basic Exclusion Amount of $11,180,000.00. The Trump Exclusion Amount "vanishes" January 1, 2026. Assume no inflation adjustment to the Basic Exclusion Amount. Assume I have $11,180,000.00 of wealth.

I give away my $11,180,000.00 of wealth prior to 2026. I pay no gift tax because my Basic Exclusion Amount of $11,180,000.00 covers the gift. I die in 2026 owning nothing. What is the Estate Tax occasioned at my death in 2026?

Estate Tax Calculation

Gross Estate	$0.00
Adjusted Taxable Gifts	+$11,180,000.00
Estate Tax Base	$11,180,000.00
Estate Tax Base	$11,180,000.00
2026 Basic/Old Exclusion Amount	<$5,590,000.00>
Exposed to Estate Tax	$5,590,000.00
Estate Tax Rate	x 40%
Estate Tax	$2,236,000.00

The 2017 Act amends IRC §2001(g) to add a new IRC §2001(g)(2) directing the Treasury to prescribe Regulations to address the Clawback issue. The use of the $5,590,000.00 Trump Exclusion Amount should not be clawed back in my estate and I should owe no death tax at my death. The Proposed Regulations, §20.2010-1(c) confirm there is no clawback in this situation.

OFF THE TOP GIFTS

I have an Old Exclusion Amount of $5,590,000.00. I have a Trump Exclusion Amount of $5,590,000.00. Combined, I have a Basic Exclusion Amount of $11,180,000.00. The Trump Exclusion Amount "vanishes" January 1, 2026. Assume no inflation adjustment to the Basic Exclusion Amount. Assume I have $11,180,000.00 of wealth.

I give away $5,590,000.00 of wealth prior to 2026. I pay no gift tax because my Basic Exclusion Amount of $11,180,000.00 covers the gift. I die in 2026 owning $5,590,000.00. What is the Estate Tax occasioned at my death in 2026?

Estate Tax Calculation

Gross Estate	$5,590,000.00
Adjusted Taxable Gifts	+$5,590,000.00
Estate Tax Base	$11,180,000.00

Estate Tax Base	$11,180,000.00
2026 Basic/Old Exclusion Amount	<$5,590,000.00>
Exposed to Estate Tax	$5,590,000.00
Estate Tax Rate	x 40%
Estate Tax	$2,236,000.00

Do gifts during the period that the Basic Exclusion Amount is $11,180,000.00 (indexed) "come off the top" of the $11,180,000.00 (indexed) Basic Exclusion Amount that applies before 2026? Said another way, do such gifts first use up the Trump Exclusion Amount? Or, do such gifts first use up the Old Exclusion Amount? Under current law if a donor who has not previously made a taxable gift makes a gift of $5,590,000.00, and if the donor dies after the Basic Exclusion Amount has been reduced to $5,590,000.00 (indexed), the donor effectively will be treated as having used the $5,590,000.00 of the Old Exclusion Amount, and the donor will not have made any use of the extra $5,590,000.00 (indexed) Trump Exclusion Amount available in 2018-2025. To take advantage of the "window of opportunity", in case the Basic Exclusion Amount is later decreased, the donor must make a gift in excess of the $5,590,000.00 Old Exclusion Amount, under the current law and the current Proposed Regulations. That is, you can lock in part or all of the Trump Exclusion Amount by making gifts. However, the lock in is only achieved with respect to gifts that used the Trump Exclusion Amount to protect from imposition of gift tax. The no-clawback rule in the Proposed Regulations only helps if the applicable credit amount allowed against prior gifts exceeds the applicable credit amount based on the Basic Exclusion Amount at death.

The Treasury might issue "new" Regulations providing that gifts come "off the top", (i.e. first, off the Trump Exclusion Amount) so that a donor who makes a $5,590,000.00 gift when the Basic Exclusion Amount is $11,180,000.00 (indexed) would still have all of his or her $5,590,000.00 Old Exclusion Amount after the Basic Exclusion Amount is reduced to $5,590,000.00 (indexed) after 2025. By analogy, the portability regulations provide that a surviving spouse "shall be considered to apply [the] DSUE amount to the taxable gift before the surviving spouse's own basic exclusion amount". That could be analogous to current law which treats the Trump Exclusion Amount as disappearing after 2025.

THREE EXCLUSION AMOUNTS

My spouse dies in 2018 leaving everything to me. I file a Form 706 claiming DSUEA of $11,180,000.00. Assume no inflation adjustment to the Basic Exclusion Amount. The DSUEA is not indexed with inflation.

I have $5,590,000.00 of Old Exclusion Amount.
I have $5,590,000.00 of Trump Exclusion Amount.
I have $11,180,000.00 of DSUEA.

1. I die in 2025 having made no Adjusted Taxable Gifts.
   I have total Exclusions of $22,360,000.00 available at death.

2. I die in 2026 having made no Adjusted Taxable Gifts.
   My Trump Exclusion Amount "vanishes" January 1, 2026.
   My Trump augmented DSUEA does not vanish January 1, 2026. *
   I have total Exclusions of $16,770,000.00 available at death.

3. I die in 2025 having made a $5,590,000.00 Adjusted Taxable Gift.
   I have total Exclusions of $22,360,000.00.
   I have a $5,590,000.00 Adjusted Taxable Gift.
   I have "net" Exclusions of $16,770,000.00 available at death.

4. I die in 2026 having made a $5,590,000.00 Adjusted Taxable Gift.
   My Trump Exclusion Amount vanishes January 1, 2026.
   My adjusted taxable gift did not use my Trump Exclusion Amount.
   My adjusted taxable gift used my Old Exclusion Amount.
   I have total Exclusions of $16,770,000.00.
   I have a $5,590,000.00 Adjusted Taxable Gift.
   I have "net" Exclusions of $11,180,000.00 available at death.

* See Regs. §20.2010-2(c)(1)

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