Tax Cuts and Jobs Act of 2017—Business Tax Provisions

By Robert E. Ward*

Robert E. Ward, J.D., LL.M. outlines the business tax provisions of the recently enacted Tax Cuts and Jobs Act of 2018.

Tax Rates

Act Section 13001: 21-Percent Corporate Tax Rate

The Act eliminates the graduated corporate rate structure and imposes a flat 21-percent tax on corporate taxable income. In addition to reducing the higher tax brackets under existing law, the prior 15-percent tax bracket for corporations with less than $50,000 in taxable income is eliminated.

Effective Date: Taxable years beginning after December 31, 2017.

Code Section Affected: Code Sec. 11(b) amended.

Sunset Date: None.

Act Section 13002: Reduction in Dividend Received Deductions to Reflect Lower Corporate Income Tax Rates

The Act reduces the general dividends received deduction for dividends received from domestic corporations from 70 percent to 50 percent and reduces the dividends received deduction on dividends from corporations in which the taxpayer has a 20 percent or greater ownership interest from 80 percent to 65 percent. The 100-percent dividends received deduction available to small business investment companies and the 100-percent dividends received deduction on qualifying dividends under Code Sec. 243 remain in effect.

For dividends received by a domestic corporation from a foreign sales corporation, the Act reduces the general dividends received deduction from 70 percent to 50 percent and reduces the dividends received deduction on dividends from foreign sales corporations in which the taxpayer has a 20 percent or greater ownership interest from 80 percent to 65 percent.

Effective Date: Taxable years beginning after December 31, 2017.

Code Sections Affected: Code Secs. 243(a)(1), 243(c)(1), 245(c)(1)(B), 246(b)(3), 246A(a)(1), and 861(a)(2) amended.

Sunset Date: None.

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Alternative Minimum Tax

Act Section 12001: Repeal of Alternative Minimum Tax for Corporations

The Act repeals the corporate alternative minimum tax.
Effective Date: Taxable years beginning after December 31, 2017.
Code Section Affected: Code Sec. 55(a) amended.
Sunset Date: None.

Act Section 12002: Credit for Prior Year Minimum Tax Liability of Corporations

Under current law, a corporation subject to alternative minimum tax in a prior year may recoup the amount of the alternative minimum tax in a later year to the extent the taxpayer's regular tax liability in such later year exceeds its tentative minimum tax in such later year. This recoupment of an alternative minimum tax paid in a prior year is known as the "*AMT Credit*."

The Act preserves the AMT Credit, allowing a corporation to offset its regular tax liability for any taxable year. Additionally, the Act provides the AMT Credit for corporations is refundable for any taxable year beginning after 2017 and before 2022.

Generally, the refundable amount is 50 percent of the excess of the AMT Credit for the tax year over the amount of the AMT Credit allowable against the regular tax liability of that year. However, for tax years beginning after December 31, 2020, the refundable amount is 100 percent of the excess of the AMT Credit for the tax year over the amount of the AMT Credit allowable against the regular tax liability of that year.

Effective Date: Generally, taxable years beginning after December 31, 2017. In regard to the conforming amendment to Code Sec. 1374(b)(3)(B), taxable years beginning after December 31, 2021.

Code Section Affected: Code Sec. 53 amended by adding subsection 53(e).

Sunset Date: The AMT Credit is refundable only for tax years beginning in 2018, 2019, 2020, or 2021.

Provisions Related to Passthrough Entities

1. S Corporations

Act Section 13541: Expansion of Qualifying Beneficiaries of an Electing Small Business Trust

Only certain types of trusts are permitted as shareholders of S corporations: grantor trusts (while the settlor of the trust is alive and for two years after), trusts to which S corporation stock is transferred by a will (but only for two years following the death of the deceased shareholder), voting trusts, electing small business trusts ("*ESBTs*"), certain individual retirement account trusts, and qualified subchapter S trusts. Generally, in the case of each trust, each beneficiary must be of the same character as those permitted to be shareholders of S corporations: individuals, another S corporation which owns 100 percent of the stock of a qualified subchapter S subsidiary, estates, and the trusts described above. Code Sec. 1361(b)(1)(C) expressly prohibits non-resident aliens from being shareholders of S corporations. The Act changes this treatment by allowing non-resident aliens to be beneficiaries of ESBTs, thereby owning the stock of the S corporation through the trust.
Effective Date: January 1, 2018.
Code Section Affected: Code Sec. 1361(c)(2)(B)(v) amended.
Sunset Date: None.

Act Section 13542: Charitable Contribution Deduction for Electing Small Business Trusts

Code Sec. 641(c) provides rules for computation of the taxable income of an ESBT. That provision limits deductions which the ESBT may claim in computing its taxable income to deductions permitted under Code Sec. 1366, state and local income taxes, certain administrative expenses, and interest expense paid or accrued on debt to acquire stock in an S corporation. Among the items which pass through to ESBTs under Code Sec. 1366 are charitable deductions made by the S corporation in which the ESBT is a stockholder.

Traditionally, ESBTs have been subject to the same limitations on deductions of charitable contributions applicable to other trusts in computing the ESBT's taxable income. The Act changes this treatment by permitting ESBTs to compute taxable income using the same rules as individuals with respect to charitable contributions. Thus, the percentage limitations (60 percent of adjusted gross income, as a result of the Act's amendment of Code Sec. 170(b)(1)) and carry forward provisions (five years for excess charitable contributions) will apply to the ESBT's share of the charitable contributions made by the S corporation in which it is a shareholder. For purposes of the charitable contribution limitation of Code Sec. 170(b)(1)(G), the Act provides that the adjusted gross income of the ESBT will be computed in the same manner as an individual except that deductions for administrative expenses will be limited to those which would not have been incurred if the property had not been held in a trust.
Effective Date: Taxable years beginning after December 31, 2017.

Code Section Affected: Code Sec. 641(c)(2) amended by adding subparagraph 641(c)(2)(e).
Sunset Date: None.

Act Section 13543: Modification of Treatment of S Corporation Conversions to C Corporations

The Act adds provisions specifically directed at S corporations which revoke S elections in response to the Act. The conversion to a C corporation raises potential issues addressed by Code Sec. 481. To resolve those issues the Act allows adjustments required by the provisions of Code Sec. 481(a) to be accounted for ratably over a period of six years beginning with the year of change for an eligible terminated S corporation. The Act defines the term "eligible terminated S corporation" as a corporation which (1) was an S corporation on the day before enactment, (2) revokes its S election under Code Sec. 1362(a) within two years of enactment, and (3) had the same owner(s) in the same proportions on the dates of enactment and revocation.

The Act also adds a provision under new Code Sec. 1371(f) which provides that cash distributions made after the post-termination transition period (as defined in Code Sec. 1377(b)) are chargeable to accumulated earnings and profits in the same ratio that the accumulated adjustment account bears to the accumulated earnings and profits of the C corporation.
Effective Date: Date of enactment.

Code Sections Affected: Code Secs. 481 amended by adding subsection 481(d) and 1371 amended by adding subsection (f).

Sunset Date: Newly created Code Secs. 481(d) and 1371(f) will not apply to conversions occurring more than two years after the date of enactment.

2. Partnerships

Act Section 13501: Treatment of Gain or Loss of Foreign Persons from Sale or Exchange of Interests in Partnerships Engaged in Trade of Business Within the United States

The Act repeals the result in *Grecian Magnesite Mining, Industrial & Shipping Co.*,[1] which held that gain realized by a non-U.S. person on the sale of an interest in a partnership engaged in a U.S. trade or business was not subject to U.S. income taxation (other than to the extent of the partnership's holdings in U.S. real property interests and hot assets under Code Sec. 751 (unrealized receivables or inventory). The Act changes the sourcing rules of the Internal Revenue Code so as to treat gain realized on the sale or exchange of a partnership interest as effectively connected income (subject to U.S. income taxation). In addition, the Act imposes a 10-percent withholding requirement on the gross proceeds derived from the sale of the partnership interest. If the seller fails to withhold the amount required, the partnership is required to deduct and withhold an amount equal to the withholding obligation from distributions to the purchaser.
Effective Date: Sales, exchanges, and dispositions on or after November 22, 2017. However, the withholding obligation is deferred and made applicable to sales, exchanges, and dispositions after December 31, 2017.
Code Sections Affected: Code Sec. 864(c) amended by adding subsection 864(c)(8). Code Sec. 1446 amended by inserting new subsection 1446(f).
Sunset Date: None.

Act Section 13502: Modify Definition of Substantial Built-In Loss in the Case of Transfer of Partnership Interest

Ordinarily when a partner sells the partner's interest in the partnership, no adjustment is made to the basis of partnership assets unless the partnership has a Code Sec. 754 election in effect or the collective basis of the partnership in its assets exceeds the fair market value of those assets by more than $250,000 (a "*substantial built-in loss*"). The Act expands the definition of substantial built-in loss to include circumstances in which the purchaser of the partnership interest would be allocated a net loss in excess of $250,000 if immediately after purchase of the partnership interest the partnership were to sell all of its assets in a fully taxable transaction for cash equal to the fair market value of the partnership assets. Such a situation could occur, for example, as a result of special allocations of gain or loss among the partners. If the purchaser of the partnership interest would recognize a net loss in excess of $250,000 on sale of all partnership assets for cash, the Act requires the purchaser's basis in partnership property to be reduced by the amount of the built-in loss.
Effective Sate: Transfers of partnership interests occurring after December 31, 2017.
Code Section Affected: Code Sec. 743(d) amended.
Sunset Date: None.

Act Section 13503: Charitable Contributions and Foreign Taxes Taken into Account in Determining Limitation of Allowance of Partner's Share of Loss

Generally, the amount of loss a partner may deduct as a result of the activities of the partnership is limited to the

partner's basis. Once the partner's basis in the partner's partnership interest is reduced to zero, losses are suspended until additional basis is acquired (for example, as the result of the partner's share of partnership net income in subsequent years). Under Code Sec. 702(a)(4) and (6), respectively, partners take into account their respective shares of the partnership's charitable contributions and foreign taxes paid. However, because of a technical glitch in the regulations under Code Sec. 704, the loss limitation rule of Code Sec. 704(d) does not apply and the partner is able to deduct the partner's share of charitable contributions and foreign taxes paid by the partnership despite inadequate basis. The Act amends the statute to proscribe such deductions until basis is acquired against which such deductions may be taken.

Effective Date: Partnership taxable years beginning after December 31, 2017.

Code Section Affected: Code Sec. 704(d).

Sunset Date: None.

Act Section 13504: Repeal of Partnership Technical Termination Rule

Current law provides that a partnership will be deemed to be terminated (resulting in a constructive distribution of all of its assets to its partners as if the partnership had been wound up and liquidated) if there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits. Termination of the partnership is also deemed to occur if, as a result of a merger or consolidation of the partnership with another partnership or a division of the partnership, the partners in the initial partnership receive or retain an interest of more than 50 percent in the capital and profits of the successor partnership.

The Act eliminates the 50-percent test and limits terminations to circumstances in which no part of any business of the partnership is continued.

Effective Date: Partnership taxable years beginning after December 31, 2017.

Code Section Affected: Code Sec. 708(b) amended.

Sunset Date: None.

Interest Limitation

Act Section 13301: Limitations on Deductions of Interest

The Act changes the limitations on deductions for business interest expense by amending Code Sec. 163(j) to provide that the deduction of business interest for any taxable year cannot exceed the sum of (1) the business interest income of the taxpayer, (2) 30 percent of the adjusted taxable income (as defined below) of the taxpayer (but not an amount below zero), and (3) the floor plan financing interest of the taxpayer for that year.

The Act permits disallowed business interest deductions to be carried forward indefinitely by the taxpayer. However, certain restrictions apply to partnerships (as discussed below).

The Act exempts small businesses from the deduction limitation if the taxpayer meets the gross receipts test under Code Sec. 448(c). To qualify for the exemption, the taxpayer's average annual gross receipts for the prior three years must not exceed $25 million.

Applicability to Partnerships and S Corporations

Code Sec. 163(j) applies at the entity level. Any deduction for business interest is taken into account in determining non-separately stated taxable income or loss of the partnership or S corporation. Consequently, to prevent double counting, the adjusted taxable income of each partner or shareholder is determined without regard to such partner's or shareholder's distributive share of any items of income, gain, deduction, or loss of the entity and is increased by the partner's or shareholder's distributive share of the entity's excess taxable income.

The excess taxable income of the entity is the amount which bears the same ratio to the partnership's adjusted taxable income (defined below) as the excess (if any) of

- 30 percent of the adjusted taxable income over
- the amount (if any) by which
  - the business interest of the partnership, reduced by floor plan financing interest, exceeds
  - the business interest income of the partnership

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- 30 percent of the adjusted taxable income of the partnership.

A partnership's excess taxable income is allocated in the same manner as non-separately stated income and loss.

Definition of Adjusted Taxable Income

The Act defines adjusted taxable income as the taxable income of the taxpayer computed without regard to (1) any item of income, gain, deduction, or loss not properly allocable to a trade or business; (2) any business interest or business interest income; (3) the amount of any net operating loss deduction, (4) the amount of any deduction allowed under Code Sec. 199A, and (5) for taxable years beginning after December 31, 2017 and before January 1, 2022, any deduction allowable for depreciation, amortization, or depletion. The Act provides that the IRS may

provide additional adjustments to the computation of adjusted taxable income.

Definition of Business Interest and Business Interest Income

The Act defines business interest as any interest paid or accrued on indebtedness properly allocable to a trade or business, but does not include investment interest within the meaning of Code Sec. 163(d). The Act defines business interest income as the amount of interest includible in the taxpayer's gross income for the taxable which is properly allocable to a trade or business (not including investment interest within the meaning of Code Sec. 163(d).)

The Act requires that business interest not allowed as a deduction to a partnership for the taxable year is allocated to each partner in the same manner as non-separately stated taxable income or loss of the partnership. The partner may deduct the partner's share of the excess business interest in any future year, but only against excess taxable income allocable to the partner by the same partnership in that year.

Basis Reduction

The Act provides that a partner's basis in the partner's partnership interest (outside basis) is reduced (but not below zero) by the amount of excess business interest allocated to the partner in the year of allocation, whether or not the partner has been able to claim deductions in the year of allocation. Deductions in future years for interest carried forward will not result in additional reductions of outside basis. If a partner whose basis has been reduced disposes of that partner's partnership interest, the partner's outside basis will be increased immediately before the disposition by the amount by which any basis reductions exceed the amount of deductions actually claimed by the partner against the partnership's excess taxable income. If basis is increased pursuant to these provisions, the opportunity to deduct excess business interest allocated to the partner is eliminated.

Definition of Trade or Business

The Act excludes from the definition of "trade or business" (1) the trade or business of performing services as an employee, (2) an electing real property trade or business, (3) an electing farming business, and (4) the trade or business of certain regulated public utilities. Consequently, the business interest limitation does not apply to a real property trade or business as defined in Code Sec. 469(c)(7)(C), to a farming business as defined in Code Sec. 263A(e)(4), or to a trade or business of a specified agricultural or horticultural cooperative as defined in Code Sec. 199A(g)(2), but only if such trade or business makes an election to not be treated as a trade or business for purposes of Code Sec. 163(j).

Observation: There is no grandfathering for pre-existing debt.

Planning Implications: It appears the limitations imposed by amended Code Sec. 163(j) on the deductibility of business interest do not apply to investment interest expense deductible (and subject to its own limitations) under Code Sec. 163(d). It may be possible to shift the characterization of the interest expense and the limitations to which its deduction is subject from business interest to investment interest expense by moving debt from the corporation which conducts the business to its shareholders who are able to borrow and then on-lend or make an equity investment in the corporation.

Effective Date: Taxable years beginning after December 31, 2017.

Code Sections Affected: Code Sec. 163(j) amended. Code Sec. 381(c) amended by adding subsection 381(c)(20).

Sunset Date: None. However, the exclusion of deductions for depreciation, amortization, and depletion from the computation of adjusted taxable income is effective only for taxable years beginning after December 31, 2017 and before January 1, 2022.

Net Operating Loss Deduction

Act Section 13302: Modification of Net Operating Loss Deduction

The Act amends Code Sec. 172(b) to limit the amount of a net operating loss which may be carried over or back to a taxable year to 80 percent of the taxable income for that prior year. In addition, beginning with losses arising in taxable years beginning after December 31, 2017, net operating losses may no longer be carried back, but may be carried forward indefinitely, with the exception of so-called "farming losses" which may still be carried back for two years.

Planning Implications: Loss of the ability to carryback NOLs will likely impact M&A transactions. Since NOLs cannot be carried back, the NOLs become a tax attribute which will have value to a purchaser of the target for which sellers will reasonably expect compensation. However, tax attributes typically do not survive asset acquisitions. Even in a stock acquisition rules under Code Secs. 269 and 382 may limit the acquiring corporation's ability to use the target NOLs. In this regard, the changes made by the Act will prevent target NOLs from expiring.

Effective Date: Applicable to losses arising in taxable years beginning after December 31, 2017, and carry forwards and carry backs applicable to net operating losses arising in tax years ending after December 31, 2017.
Code Section Affected: Code Sec. 172(a) amended.
Sunset Date: None.

Reform of Business-Related Exclusions and Deductions, *Etc.*

Act Section 13101: Modifications of Rules for Expensing Depreciable Business Assets

The Act increases a taxpayer's ability to elect to treat Code Sec. 179 property as an expense deductible in the taxable year the property is placed in service. The aggregate cost that may be treated as an expense is increased from $500,000 to $1,000,000 (referred to as the "*Limitation Amount*"). The Act also increases the threshold amount which triggers a reduction in the Limitation Amount from $2,000,000 to $2,500,000.

The Act provides that the Limitation Amount, the threshold amount, and the corresponding special amounts applicable to sport utility vehicles are to be adjusted for inflation for taxable years beginning after 2018.

The Act expands the definition of Code Sec. 179 property to include property used for lodging (as described by Code Sec. 50(b)(2)) and, at the election of the taxpayer, qualified real property. The Act repeals the current special rules for qualified real property. The term "qualified real property" is defined as any qualified improvement property described in Code Sec. 168(e)(6) and any roof, heating, ventilation, air-conditioning, fire protection, or alarm system or security system improvements which were placed in service in non-residential real property after the date the real property was first placed in service.
Effective Date: Applicable to property placed in service in taxable years beginning after December 31, 2017.
Code Section Affected: Code Secs. 179(b), (d), and (f) amended.
Sunset Date: None.

Act Section 13303: Like-Kind Exchanges of Real Property

The Act eliminates non-recognition treatment for like-kind exchanges of any asset other than real property which is not held primarily for sale in a trade or business. The Act further provides that for purposes of Code Sec. 1031 partners in partnerships electing under Code Sec. 761 will be regarded as owning undivided interests in the assets of the partnership instead of interests in the partnership, thereby enabling the partners to avoid the prohibition on like-kind exchanges of partnership interests.
Observation. Partners in partnerships making the election under Code Sec. 761 can now decide independently whether to defer gain under Code Sec. 1031 on sale of partnership real estate. This is a significant change to prior law which required the partnership to defer gain under Code Sec. 1031.
Effective Date: Exchanges completed after December 31, 2017, unless the property exchanged by a taxpayer is disposed of prior to December 31, 2017, or the property received by a taxpayer is received on or before that date.
Code Section Affected: Code Sec. 1031(a)(1) amended. Code Sec. 1031 amended by adding subject 1031(k).
Sunset Date: None.

Act Section 13304: Limitation on Deduction by Employers of Expenses for Fringe Benefits

The Act makes significant changes to various provisions of Code Sec. 274 involving meals and entertainment, club dues, employee fringe benefits, and meals provided for an employer's convenience.

Meals and Entertainment and Club Dues

The Act prohibits deduction of expenses relating to entertainment, amusement, or recreation, including (i) meals and entertainment, (ii) club membership dues of any type, (iii) or any facility used in connection with those purposes. Under current law, those expenses are deductible if the taxpayer establishes that the activity was associated with the active conduct of a trade or business.

Qualified Transportation Fringe Benefits

The Act prohibits deduction of the cost of providing employees with transportation to work (unless necessary to ensure the employee's safety), transit passes, or parking as defined in Code Sec. 132(f). Employers may continue to deduct the cost of providing employees with qualified bicycle commuting reimbursements as provided in Code Sec. 132(f)(1)(D). The amendments to Code Sec. 274 do not affect an employee's ability to exclude any amounts paid by an employer for those items from the employee's gross income under Code Sec. 132(f). The employer simply can no longer deduct those expenses.

Meals Provided for Employer's Convenience

The Act disallows expenses for eating facilities for employees which are at or near the employer's business premises

and operated on a non-profit basis and for meals which are given to an employee on the employer's premises. The amendments to Code Sec. 274 do not affect an employee's ability to exclude any amounts paid by an employer for those items from the employee's gross income under Code Secs. 132(e) and 119(a). The employer simply can no longer deduct those expenses.

Effective Date: The amendments generally apply to amounts incurred or paid after December 31, 2017, except for the rules relating to meals provided for the convenience of the employer, which are effective for amounts paid or incurred after December 31, 2025.

Code Section Affected: Code Sec. 274(a) amended.

Act Section 13305: Repeal of Deduction for Income Attributable to Domestic Production Activities

The Act repeals Code Sec. 199 in its entirety. Under current law, Code Sec. 199 provides that taxpayers may deduct from taxable income an amount equal to nine percent of the lesser of (1) the taxpayer's qualified production activities income or (2) taxable income for the tax year.

Effective Date: Taxable years beginning after December 31, 2017 (for non-corporate taxpayers and for certain rules applicable to agricultural and horticultural cooperates provided in Code Sec. 199(d)(3)(A) and (B)) and taxable years beginning after December 31, 2018 (for C corporations).

Code Section Affected: Code Sec. 199 repealed.

Sunset Date: None.

Act Section 13306: Denial of Deduction for Certain Fines, Penalties, and Other Amounts

Under current law, Code Sec. 162(f) provides that taxpayers may not deduct fines or penalties paid to a government for the violation of any law. The Act expands Code Sec. 162(f) to provide that taxpayers may not deduct amounts paid or incurred at the direction of a government or governmental entity in relation to the violation of any law or the investigation or inquiry by the government or governmental entity into the potential violation of any law. The Act provides an exception to the general rule that such expenses are not deductible if a taxpayer can demonstrate that the payments are (1) either restitution (including remediation of property) or paid to come into compliance with any law that was violated or involved in the investigation or inquiry and (2) are identified in the court order or settlement agreement as restitution or an amount paid to come into compliance with such law. If an amount is paid in restitution for the failure to pay any tax and assessed as restitution under the Code, the amount paid is deductible to the extent it would have been deductible if it had been timely paid. However, the deduction does not apply to any amount paid or incurred as reimbursement to a government or governmental entity for the costs of any investigation or litigation. Further, the provision does not apply to amounts paid or incurred by reason of any court order where a government or governmental entity is not a party.

The Act adds new Code Sec. 6050X requiring government agencies to report to the IRS and to the taxpayer involved the amount of any settlement agreement or court order where the aggregate amount to be paid by the taxpayer is at least $600. The report must identify (1) the amount required to be paid as a result of the suit or agreement, (2) the portion of such amount which is restitution or remediation, and (3) the portion of such amount paid for the purpose of coming into compliance with any law which was violated or involved in the investigation or inquiry.

Effective Date: Amounts paid or incurred on or after the date of enactment, but not for amounts paid or incurred under any binding order or agreement entered into before the date of enactment unless the required court approval was obtained after the date of enactment.

Code Sections Affected: Code Sec. 162(f) amended and new Code Sec. 6050X added.

Sunset Date: None.

Act Section 13307: Denial of Deduction for Settlements Subject to Non-disclosure Agreements Paid in Connection with Sexual Harassment or Sexual Abuse

Pursuant to Code Sec. 162(a) a taxpayer is allowed a deduction for ordinary business expenses incurred in carrying on a trade or business. However, Code Sec. 162 provides numerous exceptions to the general rule. The Act adds new Code Sec. 162(q) to the exceptions found in Code Sec. 162 to disallow deductions for amounts paid by a taxpayer in response to sexual harassment or sexual abuse claims for (1) any settlements or payments subject to a non-disclosure agreement and (2) any attorney fees.

Effective Date: Amounts paid or incurred after the date of enactment.

Code Section Affected: CodeSec. 162 amended by adding subsection 162(q).

Sunset Date: None.

Act Section 13308: Repeal of Deduction for Local Lobbying Expenses

Code Sec. 162(a) generally provides that a taxpayer is allowed a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Code Sec. 162(e) provides that taxpayers may not deduct lobbying and political expenditures. Non-deductible lobbying and political expenditures include expenses in connection with (1) influencing legislation, (2) participating or intervening in any political campaign, (3) attempting to influence the general public with respect to elections, legislative matters, or referendums, and (4) any direct communication with a covered executive branch official in an attempt to influence the person's official actions or positions.

The Act repeals the exception to Code Sec. 162(e) which allowed taxpayers to deduct amounts paid or incurred related to lobbying local councils or similar governing bodies, including Indian tribal governments. As such, the general disallowance of lobbying and political expenditures will apply to local lobbying expenses.

Effective Date: Amounts paid or incurred after the date of enactment.

Code Section Affected: Code Sec. 162(e) amended.

Sunset Date: None.

Act Section 13309: Recharacterization of Gain in the Case of Partnership Profits Interests Held in Connection with Performance of Investment Services

The Act provides that income realized by a taxpayer with regard to an applicable partnership interest will be treated as short-term capital gain unless held for more than three years, notwithstanding Code Sec. 83 or elections in effect under Code Sec. 83(b). This characterization applies only to income or gain attributable to those assets held for portfolio investment on behalf of third-party investors, to the extent provided by the IRS. The Act defines "third party investor" as a person who holds a passive interest in the partnership and is not and was not actively engaged or related to a person who is or was actively engaged in providing substantial services for the partnership or any applicable trade or business.

The Act defines the term "applicable partnership interest" as an interest in a partnership which is directly or indirectly transferred to or held by the taxpayer in connection with the performance of substantial services by the taxpayer or any related person in any applicable trade or business (excepting interests held by a person employed by another entity who provides services only to such other entity). An applicable partnership interest does not include an interest held directly or indirectly by a corporation or a capital interest which provides the taxpayer with a right to share in partnership capital commensurate with the amount of capital contributed by the taxpayer or the value of the interest subject to tax under Code Sec. 83 upon the receipt or vesting of the interest.

The Act defines "applicable trade or business" as one in which activity is conducted on a regular, continuous, and substantial basis consisting in whole or in part of (1) raising or returning capital and (2) investing in or disposing of or developing specified assets. The Act defines the term "specified assets" as securities, commodities, real estate held for rental or investment, cash or cash equivalents, options or derivative contracts with respect to any of the foregoing, and an interest in a partnership to the extent of the partnership's proportionate interest in any of the foregoing.

The Act provides that if a taxpayer transfers any applicable partnership interest to a related person, the taxpayer must include in gross income as short-term capital gain the excess of the taxpayer's allocated long-term gain related to such applicable partnership interest attributable to the sale or exchange of any partnership asset held for not more than three years over the gain on transfer of the applicable partnership interest which is treated as short-term gain.

The Act defines "related person" as a member of the taxpayer's family within the meaning of Code Sec. 318(a)(1) or a person who performed a service within the current or preceding three calendar years in any applicable trade or business in which or for which the taxpayer performed a service.

The Act requires the IRS to issue regulations regarding reporting requirements and additional guidance.

Planning Implications: The exclusion of partnership interests owned by corporations from the term "applicable partnership interests" appears to allow partnership interests owned through S corporations to avoid the three-year holding period requirement imposed by the Act.

Effective Date: Taxable years beginning after December 31, 2017.

Code Section Affected: New Code Sec. 1061 added.

Sunset Date: None.

Act Section 13310: Prohibition on Cash, Gift Cards, and other Non-Tangible Personal Property as Employee Achievement Awards

Code Sec. 274(j) allows employers to deduct the cost of up to $400 of an employee achievement award. The Act

proscribes employee achievement awards in the form of cash, cash equivalents, gift cards, gift coupons, gift certificates (other than arrangements conferring only the right to select property from a limited array of pre-selected products approved by the employer), vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items.
Effective Date: Amounts paid or incurred after December 31, 2017.
Code Section Affected: Code Sec. 274(j)(3) amended.
Sunset Date: None.

Act Section 13311: Elimination of Deduction for Living Expenses Incurred by Members of Congress

The Act provides that all amounts expended by a Member of Congress for living expenses while away from home (defined as the place of residence of a Member of Congress within the state, district, or possession the Member represents) will not be deductible for income tax purposes.
Effective Date: Taxable years beginning after the date of enactment.
Code Section Affected: Code Sec. 162 amended.
Sunset Date: None.

Act Section 13312: Certain Contributions by Governmental Entities Not Treated as Contributions to Capital

Code Sec. 118 provides an exclusion from a corporation's gross income for contributions to capital and defines and limits the circumstances in which contributions to a corporation's capital to pay for construction of certain property will qualify for the exclusion from gross income. The Act eliminates the exclusion for contributions made in aid of construction, any contribution by a customer or potential customer, and any contribution by any governmental entity or civic group (unless the contribution is made as a shareholder). The Act also directs the Treasury to issue regulations appropriate to carry out the purposes of Code Sec. 118, including guidance for determining whether a contribution is a contribution in aid of construction.
Effective Date: Applicable to contributions made after the date of enactment except for contributions made by a governmental entity pursuant to a master development plan approved prior to the date of enactment).
Code Section Affected: Code Sec. 118 amended by adding new subsection 118(b).
Sunset Date: None.

Act Section 13313: Repeal of Rollover of Publicly Traded Securities Gain into Specialized Small Business Investment Companies

The Act repeals Code Sec. 1044 which permitted a taxpayer to roll over gain from the sale of a publicly traded security into a small business investment company.
Effective Date: Sales of securities after December 31, 2017.
Code Sections Affected: Code Sec. 1044 amended.
Sunset Date: None.

Act Section 13314: Certain Self-Created Property Not Treated as a Capital Asset

The Act expands the intellectual property denied capital asset treatment by adding patents, inventions, models or designs (whether or not patented), and secret formulas or processes.
Effective Date: Taxable years beginning after December 31, 2017.
Code Sections Affected: Code Sec. 1221(a)(3) amended.
Sunset Date: None.

Act Section 13401: Modification of the Orphan Drug Credit

The Act reduces the business tax credit available to taxpayers who incur qualified clinical testing expenses while developing certain drugs for rare diseases or conditions (the orphan drug credit) from 50 percent to 25 percent and provides an election and means to compute a reduced credit.
Effective Date: Taxable years beginning after December 31, 2017.
Code Section Affected: Code Sec. 45C amended.
Sunset Date: None.

Act Section 13402: Rehabilitation Credit Limited to Certified Historic Structures

The Act repeals the 10-percent rehabilitation credit for qualified rehabilitation expenditures for qualified rehabilitated buildings (that is, pre-1936 buildings that are not certified historic structures). As revised by the Act, Code Sec. 47 continues to provide a 20-percent tax credit for qualified rehabilitation expenditures for certified historic structures. For purposes of Code Sec. 47, a certified historic structure is a building either (1) listed in the National Register of Historic Places or (2) located in a registered historic district and certified as being of historic significance to the district. The building must be placed in service during the taxable year for which the credit is claimed.

Effective Date: Applicable to amounts paid or incurred after December 31, 2017. There is a transition rule applicable to qualified rehabilitation expenditures (for a certified historic structure or a pre-1936 building) for certified historic structures and pre-1936 buildings owned or leased by the taxpayer claiming the credit on or after January 1, 2017. The 24-month period or the 60-month period selected by the taxpayer pursuant to Code Sec. 47(c)(1)(C)(i) is to begin no later than 180 days after the date of the enactment. The amendments to Code Sec. 47 made by the Act will apply to qualified rehabilitation expenditures paid or incurred after the end of the taxable year in which such 24-month or 60-month period ends.
Code Section Affected: Code Sec. 47 amended.
Sunset Date: None.

Act Section 13403: Employer Credit for Paid Family and Medical Leave

The Act creates a tax credit for compensation paid to employees while on family or medical leave. Family and medical leave is defined as leave described in Code Secs. 102(a)(1)(A)-(E) or 102(a)(3) of the Family and Medical Leave Act of 1993. Paid leave provided by an employer that does not satisfy this definition is not considered to be family and medical leave for purposes of the credit.

The amount of the credit is 12.5 percent of the wages paid to the employee while on leave. The percentage is increased by 0.25-percentage points (but not above 25 percent) for each percentage point by which the leave wage rate exceeds 50 percent of the wage rate ordinarily paid to the employee.

The credit is subject to limitations. The credit is available only if the leave wage rate of a given employee is at least 50 percent of the ordinary wage rate for that employee. The maximum amount of leave that may be taken into account with respect to any employee for any taxable year is 12 weeks. Additionally, the credit allowed with respect to any employee for any taxable year may not exceed an amount equal to the product of the normal hourly wage rate and the number of hours for which leave is taken. In the case of an employee who is not paid on an hourly basis, the wages of the employee are prorated to an hourly wage rate (according to regulations to be issued by the Secretary of the Treasury). Benefits mandated or paid for by state or local governments are not taken into account in determining the amount of paid family and medical leave provided by the employer.

Employers eligible for the credit are those which have in place a written policy that (1) provides at least two weeks of annual paid family and medical leave to qualifying full-time employees; (2) provides all qualifying non-full-time employees a commensurate amount of leave on a *pro-rata* basis; and (3) provides a leave wage rate for a given employee of at least 50 percent of the normal wage rate paid to such employee.

The Act defines "qualified employee" as one described in section 3(e) of the Fair Labor Standards Act of 1938 (as amended) who (1) has been employed by the employer for at least one year and (2) had compensation for the preceding year not in excess of 60 percent of the compensation threshold for highly compensated employees under Code Sec. 414(q)(1)(B).
Effective Date: Wages paid in taxable years beginning after December 31, 2017.
Code Section Affected: New Code Sec. 45S added.
Sunset Date: Wages paid in taxable years after December 31, 2019.

Cost Recovery and Accounting Methods

Act Section 13102: Small Business Accounting Method Reform and Simplification

The Act enables additional taxpayers to utilize the cash method of accounting by increasing the gross receipts test under Code Sec. 448(c)(1) from $5,000,000 to $25,000,000. These amounts are to be adjusted for inflation beginning after 2018, rounded to the nearest multiple of $1,000,000. The Act eliminates the requirement that the taxpayer (or its predecessor) satisfy the gross receipts test for all prior taxable years beginning after December 31, 1985, in order to be excepted from the limitation. Instead, the gross receipts test is applied only to the current taxable year.

The Act also provides corporations engaged in farming greater flexibility in their accounting methods by amending the accounting method rules under Code Sec. 447. A corporation engaged in farming which is an S corporation or which meets the gross receipts test under Code Sec. 448(c) (average annual gross receipts for the prior three years of less than $25 million) for any taxable year may use a method of accounting other than the accrual method ordinarily required under Code Sec. 447(a) for that taxable year. Mechanically speaking, by meeting the gross receipts test in a given taxable year, the farming corporation is deemed to not

be a corporation for purposes of Code Sec. 447(a) for that year.

The Act also exempts taxpayers (other than tax shelters) which meet the gross receipts test of Code Sec. 448(c) from the uniform capitalization requirements under Code Sec. 263A.

The Act also exempts taxpayers (other than tax shelters) which meet the gross receipts test of Code Sec. 448(c) from the inventory requirements imposed under Code Sec. 471. An exempt taxpayer's method of accounting for inventory will be deemed to clearly reflect income if the method either (1) treats the inventory as non-incidental materials or supplies or (2) conforms to the taxpayer's method of accounting as reflected in applicable financial statements (as described in Code Sec. 451(b)(3)) or the taxpayer's books and records.

The Act amends rules which affect the timing for recognition of income from long-term contracts by expanding the pool of construction contracts which are exempt from the percentage of completion accounting requirements under Code Sec. 460. A taxpayer (other than a tax shelter) is not required to utilize the percentage of completion method if the taxpayer either (1) estimates at the time of entering into the contract that it will be completed within two years or (2) meets the gross receipts test under Code Sec. 448 for the year in which it enters into the contract.

For sole proprietorships, the gross receipts test is applied as if the taxpayer's trade or business were a corporation.

For purposes of coordinating the above amendments with Code Sec. 481, the Act provides that changes in the method of accounting made pursuant to Act section 13102 are to be treated as initiated by the taxpayer and made with the consent of the Secretary of the Treasury for purposes of Code Sec. 481. The Act also eliminates previous provisions which imposed specific timing limitations or requirements regarding accounting for adjustments resulting from changes to accounting methods.

Effective Date: Generally, taxable years beginning after December 31, 2017. Suspense accounts established under Code Sec. 447(i) prior to enactment of the Act will be preserved notwithstanding the elimination of that section. In regard to construction contracts, the amendments to Code Sec. 460 apply to contracts entered into after December 31, 2017, in taxable years ending after that date.

Code Sections Affected: Code Sec. 263A amended by adding Code Sec. 263A(i). Code Sec. 471 amended by adding new subsection 471(c). Code Secs. 447(f), 448(c), (d)(7), and 460(e)(1)(B) amended.

Act Section 13201: Temporary 100-Percent Expensing for Certain Business Assets

The Act increases the amount of the additional first-year depreciation allowance included in the Code Sec. 167 depreciation deduction from 50 percent of the adjusted basis of the qualified property to the "applicable percentage." The Act defines the general applicable percentage as (1) 100 percent for property placed in service after September 27, 2017 and before January 1, 2023; (2) 80 percent for property placed in service after December 31, 2022 and before January 1, 2024; (3) 60 percent for property placed in service after December 31, 2023 and before January 1, 2025; (4) 40 percent for property placed in service after December 31, 2024 and before January 1, 2026; and (5) 20 percent for property placed in service after December 31, 2025 and before January 1, 2027.

For property with longer production periods described in Code Sec. 168(k)(2)(B) and certain aircraft described in Code Sec. 168(k)(2)(C) (collectively referred to as "*Subparagraph B and C Property*"), the Act extends the period for which the applicable percentage is 100 percent by one year to include property placed in service prior to January 1, 2024. The applicable percentage rate is then reduced by 20 percent for each subsequent calendar year, following the same pattern outlined above.

The Act provides for a transition rule in the case of qualified property acquired by the taxpayer prior to September 28, 2017, but placed in service after September 27, 2017. The additional first-year depreciation allowance is 50 percent for general property placed in service prior to January 1, 2018, and for Subparagraph B and C Property placed in service in 2018. The allowance is 40 percent for general property placed in service in 2018 and for Subparagraph B and C Property placed in service in 2019. The allowance is 30 percent for general property placed in service in 2019 and for Subparagraph B and C Property placed in service in 2020. No additional first-year depreciation allowance is provided for general property placed in service after 2019 or for Subparagraph B and C Property placed in service after 2020.

The Act also adjusts the special rules for certain plants bearing fruits and nuts under Code Sec. 168(k)(5) to increase the first-year depreciation deduction from 50 percent of the adjusted basis of the specified plant to the applicable percentage. The applicable percentage for fruit and nut-bearing plants is 100 percent for plants planted or grafted after September 27, 2017 and before January 1, 2023. The applicable percentage is then reduced by 20 percent for each subsequent calendar year, following the same pattern outlined above, ending with an applicable

percentage of 20 percent for plants planted or grafted after December 31, 2025 and before January 1, 2027.

The Act also repeals the "first use" requirement, meaning that taxpayers may now take the deduction for used property. The provisions of 168(k) apply to certain used property when the taxpayer did not use the property at any time prior to its acquisition by the taxpayer and the acquisition meets the requirements under Code Secs. 179(d)(2)(A)-(C) and (3). The Act amends the provisions regarding leased property to reflect this extension.

The Act excludes from property qualifying for expensing any property which is primarily used in a trade or business described in Code Sec. 163(j)(7)(A) (including performing services as an employee and electing real property and electing farming trades or businesses) and any property which is used in a trade or business which has had floor plan financing indebtedness if the interest related to such indebtedness was taken into account under Code Sec. 163(j)(1)(C).

The Act adds to the list of property qualifying for expensing qualified film or television productions and qualified live theatrical productions as both are defined under Code Sec. 181. A film or television production is placed in service when it is initially released or broadcast. A live theater production is placed in service at the time of the initial live stage performance.

The Act allows a taxpayer to elect to claim an additional first-year depreciation allowance equal to 50 percent (rather than the applicable percentage) of the adjusted basis of qualified property placed in service during the first taxable year ending after September 27, 2017. The IRS will prescribe the form and manner of making such election.
Effective Date: Generally applicable to property acquired and placed in service after September 27, 2017, in the case of specified plants, those planted or grafted after September 27, 2017. Special provisions apply to property acquired prior to September 27, 2017, but placed in service after that date.
Code Section Affected: Code Sec. 168(k) amended.
Sunset Date: Property placed in service by the taxpayer after December 31, 2026 (December 31, 2027 for longer production period property).

Act Section 13202: Modification to Depreciation Limitations on Luxury Automobiles and Personal Use Property

The Act increases the maximum allowable depreciation for passenger automobiles placed in service after December 31, 2017. Provided the additional first-year depreciation deduction under Code Sec. 168(k) is not claimed, the maximum amount of allowable depreciation is increased from $2,560 to $10,000 for the year in which automobile is placed in service. The Act increases the maximum amount of allowable depreciation from $4,100 to $16,000 for the second year, from $2,450 to $9,600 for the third year, and from $1,475 to $5,760 for fourth and later years in the recovery period.

The Act also increases the limitation on amounts of unrecovered basis treated as expenses in taxable years beginning after the recovery period from $1,475 to $5,760. The amounts are indexed for inflation for passenger automobiles placed in service after December 31, 2018.

The Act also removes computer or peripheral equipment from the definition of listed property appearing in Code Sec. 280F(d)(4).
Effective Date: Property placed in service after December 31, 2017, in taxable years ending after that date.
Code Section Affected: Code Sec. 280F amended.
Sunset Date: None.

Act Section 13204: Applicable Recovery Period for Real Property

The Act eliminates separate definitions of qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property, creating one general category of qualified improvement property. The Act defines qualified improvement property as any improvement to an interior portion of a building which is non-residential real property if such improvement is placed in service after the date such building was first placed in service. The Act excludes from qualified improvement property any improvement for which the expenditure is attributable to the enlargement of the building, an elevator or escalator, or the internal structural framework of the building.

The Act provides for a 15-year MACRS recovery period and a 20-year ADS recovery period for qualified improvement property. However, restaurant building property placed in service after December 31, 2017 that does not meet the new definition of qualified improvement property is depreciable over 25 years as non-residential real property using the straight-line method and the mid-month convention.

Conforming amendments to Code Sec. 179 replace references to qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property with a reference to qualified improvement property. Consequently, restaurant building property placed in service after December 31, 2017, that does not

meet the definition of qualified improvement property is not eligible for Code Sec. 179 expensing.

The Act also requires a real property trade or business which elects out of the limitation on the deduction for interest to use ADS to depreciate any of its non-residential real property, residential rental property, and qualified improvement property.

Effective Date: Property placed in service after December 31, 2017. For amendments relating to an electing real property trade or business, the amendment applies to tax years beginning after December 31, 2017.

Code Section Affected: Code Secs. 168(b)(3) and (e) amended.

Sunset Date: None.

Act Section 13221: Certain Special Rules for Taxable Year of Inclusion

The Act adds additional special rules regarding the taxable year in which income must be included under Code Sec. 451. Taxpayers using the accrual method of accounting must take income into account for tax purposes no later than the year the income is taken into account as revenue as reported in an applicable financial statement. The new rule does not apply to taxpayers who do not have an applicable financial statement for a taxable year or to items of gross income received in connection with a mortgage servicing contract or which are accounted for using certain special methods of accounting.

The Act defines the term "applicable financial statement" as a financial statement prepared in accordance with generally accepted accounting principles and required by the SEC to be furnished annually to shareholders. If such a statement is not available, the following statements will be deemed applicable financial statements:

1. An audited financial statement used for non-tax purposes (including credit purposes or reporting to shareholders or other owners);
2. An audited financial statement filed by the taxpayer with any Federal agency other than the SEC for non-tax purposes;
3. A financial statement made on the basis of international financial reporting standards filed with a foreign equivalent of the SEC; or
4. A financial statement filed with any other regulatory or governmental body specified by the Secretary of the Treasury.

A financial statement for a group of entities which reports the financial results of a member entity will be treated as the member entity's financial statement.

The Act provides that in the case of a contract with multiple performance obligations, allocation of the transaction price for each performance obligation must match the allocation of such items reflected in the applicable financial statement.

The Act also creates new subsection 451(c) addressing the treatment of advance payments under the accrual method of accounting. The Act defines an advance payment as a payment which the taxpayer may include fully in gross income in the year of receipt, any portion of which will be included in a financial statement for a subsequent taxable year, and which is for goods, services, or other items identified by the Secretary of the Treasury. Advance payments do not include rent, insurance premiums under subchapter L, payments with respect to financial instruments, warranty, or guarantee contracts where the primary obligor is a third party, payments subject to Code Secs. 871, 881, 1441, or 1442, or payments in property to which Code Sec. 83 applies.

If a portion of an advance payment is required to be recognized in the year of receipt pursuant to subsection 451(b), the taxpayer may elect to recognize that portion in the year of receipt and the remainder in the next taxable year. Once made, the election is applicable to all subsequent years and is irrevocable unless the taxpayer receives the consent of the Secretary to revoke. The election is to be made in accord with regulations to be issued by the Secretary. A taxpayer that ceases to exist during or with the close of a taxable year in which it receives an advance payment is not eligible to make the election. Payment is deemed received when it is actually or constructively received by the taxpayer or when it is due and payable to the taxpayer.

If a taxpayer in its first taxable year beginning after December 31, 2017, makes a change in its method of accounting which was previously prohibited but now allowed or required pursuant to the Act, that change will be deemed initiated by the taxpayer with the consent of the Secretary.

Effective Date: Generally applicable to taxable years beginning after December 31, 2017. In the case of debt instruments with original issue discount, effective for taxable years beginning after December 31, 2018, and the adjustment accounting period is six years.

Code Section Affected: Code Sec. 451 amended by adding new subsections 451(b) and (c).

Sunset Date: None.

Compensation

Act Section 13601: Modification of Limitation on Excessive Employee Remuneration

The Act enhances the limitations on deductions for excessive employee remuneration by expanding the scope of corporations and employees subject to Code Sec. 162(m). Any corporation that issues securities which are required to be registered under 15 USC 78l or which is required to file reports under 15 USC 780(d) will be subject to the new rules. The Act now includes commission income and "other performance based compensation" (as defined in Code Sec. 162(m)(4)(C)) in the definition of "applicable employee remuneration" subject to disallowance and expands the definition of covered employees under Code Sec. 162(m) to include any employee of the taxpayer

1. Who at any time during the taxable year is or was a principal executive or financial officer of the taxpayer;
2. Whose total compensation must be reported to shareholders because the employee is one of the three highest compensated officers in the taxable year (other than employees described above); or
3. Who was a covered employee of the taxpayer or its predecessor for any preceding taxable year beginning after December 31, 2016.

The Act also includes in the term "covered employee" a person whose salary would be reported to shareholders if such reporting were required.

The Act adds a new rule requiring that payments which are attributable to a covered employee's services, but which are paid to a third party, including payments made after the covered employee's death, remain "applicable employee remuneration."

Effective Date: Taxable years beginning after December 31, 2017, unless the remuneration was paid pursuant to a written binding contract in effect on November 2, 2017, and to which no material modifications are made on or after November 2, 2017.

Code Section Affected: Code Sec. 162(m) amended.

Sunset Date: None.

Act Section 13603: Treatment of Qualified Equity Grants

Code Sec. 83 has long provided that property received by an individual in connection with the performance of services (whether as an employee or independent contractor) will be treated the same as any compensatory payment of cash (including stock or other equity of the employer). If the property paid by the employer to the employee or independent contractor is non-transferable and subject to a substantial risk of forfeiture, the income recognized by the employee or independent contractor may be deferred until the property is *either* transferable or no longer subject to a substantial risk of forfeiture.

The Act provides partial relief from provisions of Code Sec. 83 for stock acquired on exercise of stock option or on equity settlements of restricted stock units issued by corporations to employees who meet the eligibility requirements of the Act (referred to as "*qualified equity*"). Full-time employees of privately held corporations which adopt a written plan applicable to at least 80% of the employees who work for the corporation in the United States (or U.S. possessions) may, by election, defer the income recognized on the qualified equity until the first of the following events occurs:

1. The stock becomes transferable,
2. The employee no longer satisfies the eligibility requirements explained below,
3. Any shares of the corporation become publicly traded,
4. Five years after the first time the employee can transfer the stock or the stock is no longer subject to a substantial risk of forfeiture (whichever occurs first), or
5. The employee revokes the election.

In order to be eligible, the employee must be an individual who

1. Customarily is employed for more than 30 hours a week;
2. Does not own more than 1 percent of the stock of the employer either in the year in which the stock is acquired or the 10-preceding calendar years;
3. Is and has not been a chief executive officer ("*CEO*") or chief financial officer ("*CFO*") of the corporation or a family member of the CEO or CFO; and
4. Is not one of the four highest compensated officers of the corporation either in the year the stock is acquired or the ten preceding calendar years.

The election will be made in the same manner as elections under Code Sec. 83(b). However, unlike the 83(b) elections, the 30-day period for making the election runs from the first date the rights of the employee to the qualified stock are transferable or not subject to substantial risk of forfeiture. The election is not available if the employee can

receive cash in lieu of the qualified stock or sell the stock to the corporation.

Observation. The practical effect of the new provision is to extend by five years the time at which the employee must take the fair market value of the qualified equity into income even though the shares are no longer subject to a substantial risk of forfeiture. The amount of income the employee recognizes at the end of the deferral period will be based on the value of the stock at the time the employee's rights in the stock first became transferable or no longer subject to a substantial risk of forfeiture. This could be greater or less than the value of the stock at the end of the five-year deferral period.

Effective Date: Options exercised or restricted stock units settled in stock after December 31, 2017.

Code Section Affected: Code subsection 83(i) added.

Sunset Date: None.

Act Section 13604: Increase in Excise Tax Rate for Stock Compensation of Insiders in Expatriated Corporations

Under Code Sec. 4985, officers, directors, and 10-percent shareholders of corporations who have expatriated (that is, engaged in a corporate inversion) are subject to a 15-percent excise tax on the fair market value of equity compensation which they or a member of their family have received at any time during a 12-month period beginning 6 months before the corporation expatriated.

The Act increases the excise tax from 15 to 20 percent.

Effective Date: Corporations expatriating after the date of enactment.

Code Section Affected: Code Sec. 4985(a)(1) amended.

Sunset Date: None.

Opportunity Zones

Act Section 13823: Opportunity Zones

The Act encourages investment in qualified opportunity zones by providing for (1) the deferral of inclusion in gross income for capital gains reinvested in a qualified opportunity fund and (2) an exclusion of gains from sales or exchanges of any assets with unrelated parties equal to the taxpayer's investments in a qualified opportunity fund.

The Act defines a "qualified opportunity zone" as a population census tract that is a low-income community designated as a qualified opportunity zone. Pursuant to Code Sec. 1400Z-1(b), the chief executive officer of the State (including the District of Columbia and any U.S. possession) may nominate communities to the Secretary of the Treasury for certification as a qualified opportunity zone. The number of population census tracts designated as qualified opportunity zones may not exceed 25 percent of the number of low-income communities in a state (except if the number of low-income communities in the state is less than one hundred, then a total of 25 of such communities may be designated).

The Act defines a "qualified opportunity fund" as "any investment vehicle organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified opportunity zone property…" Further, "qualified opportunity zone property" means property which is (1) qualified opportunity zone stock, (2) any qualified opportunity zone partnership interest, and (3) any qualified opportunity zone business property.

If a qualified opportunity fund fails to meet the 90-percent requirement, the fund is required to pay a penalty for each month it fails to meet the requirement equal to the excess of an amount equal to 90 percent of its aggregate assets over the aggregate amount of qualified opportunity zone property held by the fund. The excess is multiplied by the underpayment rate established under Code Sec. 6621(a)(2). If the qualified opportunity fund is a partnership the penalty imposed is taken into account proportionately as part of the distributive share of each partner.

The amount of gains from sales or exchanges with unrelated parties cannot exceed the aggregate amount invested by the taxpayer in a qualified opportunity fund during the 180-day period beginning on the date of sale or exchange.

The basis of a taxpayer's investments in the qualified zone fund may be increased by (1) an amount equal to 10 percent of the amount of deferred gain if the investment is held for at least five years and (2) by an additional 5 percent of the amount of the deferred gain if held for seven years. The deferred gain is recognized on the earlier of the date the qualified opportunity zone investment is sold or December 31, 2026. Further, post-acquisition gains on investments in the opportunity zone funds that are held for at least 10 years are entirely excluded from gross income. At the taxpayer's election, on sale or exchange of an investment in a qualified zone fund held for more than 10 years, the basis of the investment will be the fair market value of the investment on the date of the sale or exchange.

Effective Date: Date of enactment.

Code Section Affected: Code Secs. 1400Z-1 and 1400Z-2 added.

Sunset Date: Designation of a qualified opportunity zone remains in effect through the tenth calendar year after the

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year in which the qualified opportunity zone was initially designated. Elections for deferral or non-recognition of gains apply to sales and exchanges on or before December 31, 2026.

ENDNOTES

* This article would not have been possible without the able assistance of other lawyers in the Bethesda office of WardChisholm, P.C.: Richard S. Chisholm, Alison Keller-Micheli, Bridget A. Alzheimer, and Alyson Hoffman.

1 *Grecian Magnesite Mining, Industrial & Shipping Co.*, 149 TC No. 3, Dec. 60,968 (July 13, 2017).

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