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Key Provisions of the Tax Cuts and Jobs Acts

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The **Tax Cuts and Jobs Act** or **TCJA** is the new tax law effective for tax years beginning January 1, 2018 or later. TCJA has many interconnected parts and it is not yet completely clear how some of these parts will co-exist to impact certain taxpayers. Already, many questions have arisen regarding interpretation of terms and competing provisions. There are many areas which could be aided by technical corrections or Treasury Regulations to clarify what even government officials concede is murky or inconsistent language. However, highlights of the TCJA are as follows.

EXEMPT ORGANIZATIONS

Nonprofit Executive Compensation

Internal Revenue Code §4960 was added by the TCJA, and imposes a 21% excise tax on any **executive compensation** for an employee of the tax-exempt organization that is in excess of $1 million. The excise tax is to be paid by the employer and is tied to the corporate rate. It is unknown if the tax will be paid as part of the Form 990-T or if the excise taxes will be added to the Form 990, Form 990-PF, or a separate form to be attached to the exempt organization s filing. The excise tax applies only to the top five executives paid over $1 million, plus certain former executives, and includes all remuneration and benefits other than amounts that are excludable from the executive s gross income such as donations to a qualified retirement plan. The covered organizations include all nonprofit organizations described under §501(a), along with §527 political organizations, §115 state and local governmental entities, and farmers cooperatives. Amounts paid by the employer to a Roth IRA are not included within the definition of remuneration , nor are amounts that are subject to a substantial risk of forfeiture. There is some debate as to whether public colleges and universities are covered by this provision. Public educational institutions are not necessarily exempt under §115(1) and most have not sought exempt status under §501(c)(3).

In addition, employers of licensed medical personnel receiving remuneration for the provision of medical services, including veterinarians providing vet services, are exempt from this excise tax. The definition of medical services is not included in the statutory language, and so until further guidance is provided through Treasury Regulations or judicial decisions, it could be broadly interpreted to include licensed hospital administrators performing some medical services, even if they do not provide direct patient services. It may be that the wisest course of action is to bifurcate the income, and to the extent remuneration for services that are not clearly medical services exceeds $1 million, the excise tax would be applicable.

Under a separate provision, excess parachute payments are subject to the 21% excise tax as well Generally the excise tax will apply if the amount of the parachute payment (generally paid upon separation from employment) is more than three times the employee s five year average annual compensation, even if the amount is under $1 million. The excise tax applies to the entire amount that is more than the employee s average annual

compensation.

An employee s compensation subject to the excise tax includes not only remuneration from the primary employer, but also remuneration from related organizations which are defined through the application of a control test. This also includes IRC §509(a)(3) supporting and supported organizations and IRC § 501(c)(9) voluntary employees beneficiary associations (VEBA). In a situation of more than one employer, the excise tax is paid proportionally by each employer. IRC §4960(d) directs the Secretary to prescribe regulations to prevent avoidance of the excise tax through use of a pass-through or other entity established specifically to avoid the excise tax. However, until guidance is issued the new provisions may be interpreted favorably toward taxpayers, including any work-around structures, within reason. However, legal guidance should be requested before structuring a work-around for the excise taxes.

New Taxes on Colleges and Universities

New § 4968 imposes a 1.4% excise tax on the net **investment income** of private colleges and universities with 500 or more students, and with assets of at least $500,000 per student (valued at fair market value) excluding assets used directly in carrying out the educational activities. Also, more than 50% of the institution s students must be located in the United States. There is currently no guidance regarding the definition of the assets that are used directly in carrying out educational activities. Although some educational institutions have expressed concern with their ability to fund scholarships due to this excise tax, there are planning opportunities regarding classification of assets to measure the $500,000 per student figure. To the extent assets are dedicated for scholarships there is an argument that those accounts are used directly in carrying out educational activities and should not be included as part of the assets making up the per student number. It is probable that there will eventually be guidance on this issue, but it is not clear that the guidance will be forthcoming for purposes of the 2018 tax year.

Unrelated Business Taxable Income

Section 512(a) was amended by the TCJA by adding paragraph (6): An organization s **unrelated business income tax** is to be computed separately for each unrelated business. An organization will not be able to offset income from one unrelated business with the losses from another unrelated business. Any prior year net operating loss carryforward will still be allowed to offset that unrelated business income. However, §512(a)(6) does not allow net losses to carry forward except to offset the gains for that particular business. The net business taxable income from each business will not be less than zero . Of concern to many nonprofits is the subjective nature of determining each unrelated business. It is likely that guidance will be forthcoming on this issue, but currently an organization s interrelated businesses are in uncertain territory and the level of risk the organization wishes to assume will presumably dictate how each organization interprets the provision.

Stadium Seating Not Deductible

Section §170(l) was amended by the TCJA and repeals a donor s charitable contribution deduction for contributions to colleges and universities that provide the donor with the right to purchase tickets and/or receive preferential seating at **athletic events**.

CORPORATIONS

As has been widely publicized, the primary benefit to corporations from TCJA is the lower corporate tax rate of 21%. Some other highlights include that the corporate alternative minimum tax (AMT) was repealed with provisions allowing AMT credit carryovers to offset regular tax liability for the next three years with 50%

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refundable. Also, § 168(k) allows 100% expensing through 2022 for qualified depreciable property to corporate taxpayers. Newly amended § 1031 allows like-kind exchanges only for real estate transactions. Finally, the net operating loss (NOL) deduction under §172 is limited to 80% of taxable income, with a repeal of the option to carryback the NOL in exchange for an indefinite period of time for the carryforward of any NOLs.

Some of the more interesting and widely applicable provisions that have been amended for purposes of corporate tax accounting include the elimination of many of the tax deductions previously enjoyed by corporate employers. The deductions for expenses incurred for client entertainment have been repealed, for the most part. Business lunches with clients are still deductible (50%) and food and entertainment expenses for employees remain deductible by the corporate employer. Also, expenses for employees to attend conferences are generally deductible, although there are detailed substantiation requirements for cruise ship and international conventions.

Also, there is no longer a deduction for any transportation expenses paid by the employer for employees including parking and public transit other than the minimal bicycle expense benefit. One option is to include the benefit in an employee s wages so that it is subject to withholding and within the taxable income of the employee. It would then be deductible by the employer as wage income. Additionally expenses for recreational, social, or similar activities ..primarily for the benefit of employees (other than employees who are highly compensated employees within 414(q)) are deductible. Thus, as long as the entertainment is for mid-level and entry-level employees, the expenses are deductible by the corporate employer. For example, the expense for season tickets for sporting events is still deductible if the corporate employer provides them primarily to employees rather than clients.

INTERNATIONAL TAX PROVISIONS

The tax system for international entities changed substantially, with an attempt to more closely replicate a territorial tax system rather than a worldwide tax system. Previously a U.S. taxpayer was taxed on worldwide income with a system of treaties with favored nations lowering the rates of withholding and taxes, along with foreign tax credits allowed for taxes paid to foreign taxing jurisdictions.

An immediate key portion of the new international tax regime is for the deferred income of U.S. corporations, held offshore, to be subject to tax in 2018. This is portrayed as an incentive for these corporations to bring those funds back to the United States. These Deferred Foreign Income Corporations (**DFIC**) are now subject to tax to the extent of a complex set of formulae with regard to income that has been deferred since the 1986 tax act went into effect. IRC §965 now treats the deferred foreign income as subpart F income, with various modifications, including that deficit Earnings & Profits are taken into account. Without getting into the weeds, the resulting deferred income is subject to tax at either 8% or 15.5%. These percentages are defined terms called equivalent percentages , and the deferred income is subject to a separate set of conditions determining which percentage is applicable. The IRS Office of Chief Counsel has already issued two IRS Notices to deal with confusion on §965 and the Deferred Foreign Income Corporations. *See* IRS Notice 2018-07 and IRS Notice 2018-13.

The new territorial tax system is a hybrid, rather than a pure territorial system. There are various provisions that were implemented to attempt to discourage evasionary tactics. For example, the following acronyms are now part of the tax discussions engaged in by tax professionals trying to make sense of this very lengthy and complex tax legislation. These acronyms provide some of the anti-abuse provisions:

> **BEAT**: Base Erosion and Anti-Abuse Tax (think Alternative Minimum Tax for international transactions; corporate AMT repealed)
>
> **GILTI**: Global Intangible Low-Taxed Income. And yes, it is pronounced guilty .

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QBAI: Qualified Business Asset Investment

FDII: Foreign Derived Intangible Income. Applies to income that is not GILTI.

DRD: Dividends Received Deduction (§245A). This provides a 100% deduction for foreign source dividends received by US shareholder (10% by vote or value) in certain situations.

Subpart F: Subpart F remains, although Subpart F income attributable to controlled foreign corporations is now taxed at the new corporate rate of 21%. (§951 through §964)

BEAT: The Base Erosion and Anti-Abuse Tax (§59A) applies to large corporations with $500 million or more annual gross receipts (3 year average). It is a limited alternative minimum tax primarily on related-party payments. The BEAT liability is equal to the excess of 10% (5% as a phase-in for 2018) of the modified taxable income over the taxpayer s regular tax liability reduced by certain credits. It applies to corporations, other than a RIC, REIT or S Corporation. A base erosion payment is the amount paid or accrued to a foreign related person, where that payment is deductible, or the acquisition of depreciable property, reinsurance payments, or certain amounts paid or accrued to surrogate foreign corporations which result in a reduction of gross receipts of the taxpayer. Certain services are excepted from the BEAT tax, when those services are eligible for the cost method under §482 for purposes of transfer pricing. Other limited exceptions also are available.

GILTI taxes most foreign earnings, other than Subpart F, but is taxed at one-half the U.S. corporate tax rate or 10.5% and applies only to CFCs. In addition, GILTI excludes a 10% annual return of the adjusted tax basis of tangible assets. GILTI is calculated separately for each U.S. shareholder. GILTI is tested income which is the gross income of a CFC, subtracting out effectively connected income; Subpart F income; §954(b)(4) high tax exception income; dividends from a related person; and foreign oil and gas extraction income. Also, §954(b)(5) deductions allocable to the gross income are allowed. This tested income amount is then offset by the net deemed tangible income return, which equals GILTI which is taxed at 10.5%. The net deemed tangible income return is the QBAI multiplied by 10% less any interest expense.

FDII, or Foreign Derived Intangible Income, taxes a U.S. resident on deemed intangible income. Deemed intangible income is any return over and above 10% of the tangible assets. Above 10% is assumed to be attributable to intangible assets. Certain deductions are allowed and to avoid double taxation, the GILTI income is excluded from FDII. Combining GILTI and FDII, there is less incentive for offshore holding of intellectual property. However, moving intellectual property back to the U.S. is not generally advised, since the worst case scenario is a parity whether held in the U.S. or foreign low-tax country.

This is a very high level summary of some of the new international tax provisions. There are many exceptions, exclusions, caveats and other factors which could impact tax liability. Thus, this is intended to provide a big picture view which is likely to be refined and clarified as technical corrections are issued, along with the promised Treasury Regulations. However, it is not expected that additional legislation or formal guidance such as Treasury Regulations will be forthcoming in 2018 regarding these international tax provisions.

PARTNERSHIPS AND OTHER PASS-THROUGHS

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Section 199A was added by the TCJA and provides a new 20% deduction for combined qualified business income (CQBI) and qualified cooperative dividends for pass-through entities. The deduction is taken at the partner level. However, these provisions only apply for certain types of businesses. For example, businesses which provide professional services, such as law firms and accounting firms, are not eligible for the deduction. Architectural and engineering firms, on the other hand, are specifically included as service organizations that are eligible for the deduction. §199A(d). To calculate CQBI, the taxpayer must include only U.S. effectively connected income and no investment income. The limitation is equal to the greater of 50% of W-2 wages or 25% of W-2 wages plus 2.5% of unadjusted basis in qualified property to determine Qualified Business Income (QBI). The QBI is separately added for each trade or business, including REIT dividends and certain Publicly Traded Partnership (PTP) income. The deduction is taken at the partner level.

Other provisions applicable to partnerships include §163(j) and the limitation on interest deductions to 30% of adjusted taxable income and §168(k) regarding 100% expensing for depreciable tangible property for property placed in service after 9/27/17 and before 1/1/23.

IRS Notice 2018-08 was recently issued stating that Treasury and the IRS would not enforce the new §1446(f) withholding requirements on the disposition of publicly traded partnership interests until Treasury regulations or other guidance is issued. The Notice states that stakeholders reported significant practical problems in complying with this new statutory requirement, and so Treasury and the IRS determined that withholding under new §1446(f) should not be required with respect to any disposition of an interest in a publicly traded partnership until regulations or other guidance have been issued under new §1446(f). Note that the suspension only applies to dispositions of partnership interests that are publicly traded. It does not apply to non-publicly traded interests.

INCREASED ESTATE, GIFT AND GENERATION SKIPPING TAX EXEMPTIONS

While the estate and gift tax regime survived, the lifetime exemption doubled, and so each taxpayer has an $11.2 million exemption from federal estate and gift taxes, and a separate $11.2 million exemption from the GST tax. This increased exemption sunsets on December 31, 2025, absent future Congressional action. Thus, a taxpayer could transfer up to $11.2 million to recipients who were two or more generations below the taxpayer without generating a GST tax liability. If there are no legislative changes, taxpayers with large estates would be well advised to make generous gifts prior to 2026 to take advantage of the increased exemption amounts. §§2001(g); 2010(c)(3)(C); 2631(c).

Caveat and Conclusion

This Client Alert is intended only as a high level summary of some of the provisions of the TCJA. The complexities and intricacies of each provision are beyond the scope of this Alert. Each tax situation is dependent upon its own unique facts and circumstances, and therefore taxpayers are encouraged to seek professional advice when determining whether these and other provisions of the TCJA are applicable. The tax community is awaiting promised guidance from the IRS and Department of Treasury on the provisions discussed above, among others. In addition, there are provisions of unnecessary complexity and subjectivity that would benefit from corrective legislation by Congress. Therefore, before relying upon any of the new tax provisions, it is best to ensure that the interpretation is based upon the most recent legislation and the most recent Treasury guidance.

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