WESTERN™ CPE
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Tax Cuts and Jobs Act Summary

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Course CPE Information

Course Expiration Date
Per AICPA and NASBA Standards (S9-06), QAS Self-Study courses must include an expiration date that is ***no longer than one year from the date of purchase or enrollment***.

Field of Study
Taxes (in NY Taxation). Some state boards may count credits under different categories—check with your state board for more information.

Course Level
Overview.

Prerequisites
There are no prerequisites.

Advance Preparation
None.

Course Description
The Tax Cuts & Jobs Act ("TCJA") was approved by Congress on December 20, 2017, and signed by President Trump on December 22, 2017. The Act impacts virtually every individual and business in a way not seen in over 30 years. With most provisions effective 2018 and later, it lowers the individual and corporate tax rates, repeals numerous tax credits and deductions, enhances the child tax credit, boosts business expensing, and impacts the Affordable Care Act (ACA) by effectively repealing the individual mandate.

This course is an overview providing reference to selected individual, education, business, retirement, insurance, international and estate tax provisions enacted or indexed for inflation by the TCJA. The resulting major tax changes carry special meaning to the tax practitioner and return preparer. The course is in-tended to be a resource for tax professionals and staff alike to gain easy access to the most important major changes enacted by TCJA.

Publication/Revision Date
March 2020

Instructional Design

This Self-Study course is designed to lead you through a learning process using instructional methods that will help you achieve the stated learning objectives. You will be provided with course objectives and presented with comprehensive information and facts demonstrated in exhibits and/or case studies. Review questions will allow you to check your understanding of the material, and a qualified assessment will test your mastery of the course.

Please familiarize yourself with the following instructional features to ensure your success in achieving the learning objectives.

Course CPE Information

The preceding section, "Course CPE Information," details important information regarding CPE. If you skipped over that section, please go back and review the information now to ensure you are prepared to complete this course successfully.

Table of Contents

The table of contents allows you to quickly navigate to specific sections of the course.

Learning Objectives and Content

Learning objectives clearly define the knowledge, skills, or abilities you will gain by completing the course. Throughout the course content, you will find various instructional methods to help you achieve the learning objectives, such as examples, case studies, charts, diagrams, and explanations. Please pay special attention to these instructional methods, as they will help you achieve the stated learning objectives.

Review Questions

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

Review Question Answers and Rationales

Review question answer choices are accompanied by unique, logical reasoning (rationales) as to why an answer is correct or incorrect. Evaluative feedback to incorrect responses and reinforcement feedback to correct responses are both provided.

Glossary

The glossary defines key terms. Please review the definition of any words you are not familiar with.

Index

The index allows you to quickly locate key terms or concepts as you progress through the instructional material.

Qualified Assessment

Qualified assessments measure (1) the extent to which the learning objectives have been met and (2) that you have gained the knowledge, skills, or abilities clearly defined by the learning objectives for each section of the course. Unless otherwise noted, you are required to earn a minimum score of 70% to pass a course. If you do not pass on your first attempt, please review the learning objectives, instructional materials, and review questions and answers before attempting to retake the qualified assessment to ensure all learning objectives have been successfully completed.

Answer Sheet

Feel free to fill the Answer Sheet out as you go over the course. To enter your answers online, follow these steps:

1. Go to www.westerncpe.com.
2. Log in with your username and password.
3. At the top right side of your screen, hover over "My Account" and click "My CPE."
4. Click on the big orange button that says "View All Courses."
5. Click on the appropriate course title.
6. Click on the blue wording that says "Qualified Assessment."
7. Click on "Attempt assessment now."

Evaluation

Upon successful completion of your online assessment, we ask that you complete an online course evaluation. Your feedback is a vital component in our future course development.

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Tax Cuts and Jobs Act

Learning Objectives:

After completing this course, you will be able to:

- Apply changes imposed by the Tax Cuts & Jobs Act (TCJA) relating to individual income taxes by identifying:
  - modifications to tax rates & the personal exemption,
  - AMT exemptions,
  - changes to the child tax credit,
  - new educational incentives & student loan discharge rules,
  - Mortgage interest & suspended deduction provisions, *and*
  - Alimony & estate taxation changes.
- Point out key TCJA business provisions, including new corporate tax rates, expanded §179 expensing, denial of certain entertainment expenses, and business credits.
- Recognize TCJA changes to:
  - insurance taxation,
  - tax treatment of excess of compensation,
  - deferred foreign income provisions, *and*
  - exempt organization and international taxation.

The Tax Cuts & Jobs Act (H.R. 1) was approved by Congress on December 20, 2017, and signed by President Trump on December 22, 2017. The Act impacts virtually every individual and business in a way not seen in over 30 years. With most provisions effective 2018 and later, it lowers the individual and corporate tax rates, repeals numerous tax credits and deductions, enhances the child tax credit, boosts business expensing, and impacts the Affordable

Rates, Standard Deduction, Exemptions & Credits

Care Act (ACA) by effectively repealing the individual mandate.

Individual Income Tax Rates - 7 Brackets but, Lower Rates

Prior or Existing Law: For tax year 2017, there were seven regular individual income tax brackets of 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. In addition, there are five categories of filing status: single, head of household, married filing jointly (and surviving spouses), married filing separately, and estates and trusts.

The tax rate schedules for 2017 were:

Filing Status	Taxable Income Rate	
Single	\$1 to \$9,325	10%
	\$9,325 to \$37,950	15%
	\$37,950 to \$91,900	25%
	\$91,900 to \$191,650	28%

	$191,650 to $416,700	33%
	$416,700 to $418,400	35%
	Over $418,400	39.6%
Head of Household	$1 to $13,350	10%
	$13,350 to $50,800	15%
	$50,800 to $131,200	25%
	$131,200 to $212,500	28%
	$212,500 to $416,700	33%
	$416,700 to $444,550	35%
	Over $444,550	39.6%
Married, Joint	$1 to $18,650	10%
	$18,650 to $75,900	15%
	$75,900 to $153,100	25%
	$153,100 to $233,350	28%
	$233,350 to $416,700	33%
	$416,700 to $470,700	35%
	Over $470,700	39.6%
Married, Separate	$1 to $9,325	10%
	$9,325 to $37,950	15%
	$37,950 to $76,550	25%
	$76,550 to $116,675	28%
	$116,675 to $208,350	33%
	$208,350 to $235,350	35%
	Over $235,350	39.6%

For married individuals filing jointly, the upper bounds of the 10% and 15% brackets were exactly double the upper bounds that apply to single individuals, to prevent a marriage penalty from applying at these income levels. The income levels for each bracket threshold are indexed annually based on increases in the Consumer Price Index (CPI).

Tax Cuts & Jobs Act Changes: The Act temporarily replaces the existing rate structure with a new rate structure. As a result, tax rate schedules for 2020 are:

Filing Status	**Taxable Income Rate**	
Single	$1 to $9,875	10%
	$9,875 to $40,125	12%
	$40,125 to $85,525	22%
	$85,525 to $163,300	24%
	$163,300 to $207,350	32%
	$207,350 to $518,400	35%
	Over $518,400	37%
Head of Household	$1 to $14,100	10%

	$14,100 to $53,700	12%
	$53,700 to $85,500	22%
	$85,500 to $163,300	24%
	$163,300 to $207,350	32%
	$207,350 to $518,400	35%
	Over $518,400	37%
Married, Joint	$1 to $19,750	10%
	$19,750 to $80,250	12%
	$80,250 to $171,050	22%
	$171,050 to $326,600	24%
	$326,600 to $414,700	32%
	$414,700 to $622,050	35%
	Over $622,050	37%
Married, Separate	$1 to $9,875	10%
	$9,875 to $40,125	12%
	$40,125 to $85,525	22%
	$85,525 to $163,300	24%
	$163,300 to $207,350	32%
	$207,350 to $311,025	35%
	Over $311,025	37%

Unlike prior law, which used a measure of the CPI-U, the new inflation adjustment uses the C-CPI-U.

Effective date: The changes apply to taxable years beginning after 2017, and beginning before 2026.

Unearned Income of Children - Simplified Taxation

Prior or Existing Law: Special rules (generally referred to as the "kiddie tax") apply to the net unearned income of certain children. Generally, the kiddie tax applies to a child if:

(1) the child has not reached the age of 19 by the close of the taxable year, or the child is a full-time student under the age of 24, and either of the child's parents is alive at such time;

(2) the child's unearned income exceeds $2,100 (for 2017); and

(3) the child does not 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 above age 17, the kiddie tax applies only to children whose earned income does not exceed one-half of the amount of their support.

Under these rules, the net unearned income of a child (for 2017, unearned income over $2,100) is taxed at the parents' tax rates if the parents' tax rates are higher than the tax rates of the child. The remainder of a child's taxable income (i.e., earned income, plus unearned income up to $2,100 (for 2017), less the child's standard deduction) is taxed at the child's rates, regardless of whether the kiddie tax applies to the child.

Tax Cuts & Jobs Act Changes: The Act simplifies the "kiddie tax" by effectively applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child. Thus, as under present law, taxable income attributable to earned income is taxed according to an unmarried taxpayers' brackets and rates. Taxable income attributable to net unearned income is taxed

according to the brackets applicable to trusts and estates, with respect to both ordinary income and income taxed at preferential rates.

> **Note:** The child's tax is unaffected by the tax situation of the child's parent or the unearned income of any siblings.

Effective date: The changes apply to taxable years beginning after 2017, and beginning before 2026.

Capital Gain & Qualified Dividend Rate

Prior or Existing Law: In the case of an individual, estate, or trust, any adjusted net capital gain which otherwise would be taxed at the 10% or 15% rate is not taxed. Any adjusted net capital gain which otherwise would be taxed at rates over 15% and below 39.6% is taxed at a 15% rate. Any adjusted net capital gain which otherwise would be taxed at a 39.6% rate is taxed at a 20% rate.

Unrecaptured §1250 Gain: The unrecaptured §1250 gain is taxed at a maximum rate of 25%, and 28% rate gain is taxed at a maximum rate of 28%. Any amount of unrecaptured §1250 gain or 28% rate gain otherwise taxed at a 10% or 15% rate is taxed at the otherwise applicable rate.

Net Investment Income: A tax is imposed on net investment income in the case of an individual, estate, or trust. In the case of an individual, the tax is 3.8% of the lesser of net investment income, which includes gains and dividends, or the excess of modified adjusted gross income over the threshold amount.

> **Note**: The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in the case of any other individual.

Tax Cuts & Jobs Act Changes: The Act generally retains the prior-law maximum rates on net capital gain and qualified dividends. For 2020, the 15% capital gain tax rate breakpoint is $80,000 ($40,000, for single filers) for joint returns and surviving spouses. The 20% capital gain tax rate breakpoint is $496,600 ($441,450, for single filers) for joint returns and surviving spouses. Below is a chart of capital gain rates (MFJ) based on income for 2020:

Income	Capital Gains Rate
$0 - $80,000	0%
$80,000 - $496,600	15%
Over $496,600	20%

Unrecaptured §1250 Gain: As under present law, unrecaptured §1250 gain generally is taxed at a maximum rate of 25%, and 28% rate gain is taxed at a maximum rate of 28%.

Effective date: The changes apply to taxable years beginning after 2017, and beginning before 2026.

Standard Deduction Increased

Prior or Existing Law: An individual reduces adjusted gross income (AGI) by any personal exemption deductions and either:

(1) the applicable standard deduction, *or*
(2) his or her itemized deductions to determine taxable income (§63).

The basic standard deduction varies depending upon a taxpayer's filing status. For 2017, the amount of the standard deduction was $6,350 for single individuals and married individuals filing separate returns, $9,350 for heads of households, and $12,700 for married individuals filing a joint return.

Tax Cuts & Jobs Act Changes: The standard deduction is increased to $24,000 for joint filers (and surviving spouses) and $12,000 for individual filers. Single filers with at least one qualifying child could claim a standard deduction of $18,000. These amounts are adjusted for annual inflation.

Effective date: The changes apply to taxable years beginning after 2017, and beginning before 2026.

Personal Exemptions Repealed

Prior or Existing Law: A taxpayer generally may claim personal exemptions for the taxpayer, the taxpayer's spouse, and any dependents (§151). For 2017, taxpayers may deduct $4,050 for each personal exemption. This amount is indexed annually for inflation.

Tax Cuts & Jobs Act Changes: The deduction for personal exemptions and the personal exemption phase-out are repealed.

> **Comments:** The personal exemption for the taxpayer and taxpayer's spouse would be consolidated into a larger standard deduction. The personal exemption for children and dependents would be consolidated into an expanded child tax credit and a new family tax credit.

Effective date: The changes apply to taxable years beginning after 2017, and beginning before 2026.

Alternative Minimum Tax Exemption Increased

Prior or Existing Law: Taxpayers must compute their income for purposes of both the regular income tax and the alternative minimum tax (AMT), and their tax liability is equal to the greater of their regular income tax liability or AMT liability. In computing the AMT, only alternative minimum taxable income (AMTI) above an AMT exemption amount is taken into account, but AMTI represents a broader base of income than regular taxable income. For example, personal exemptions, the standard deduction, and certain itemized deductions (such as the deduction for State and local taxes) are not allowed in calculating AMTI. In addition, many business tax preferences that are allowed for regular taxable income are not allowed in determining AMTI, including accelerated depreciation. Corporations and, in some cases, non-corporate taxpayers receive a credit for AMT paid, which they may carry forward and claim against regular tax liability in future tax years (to the extent such liability exceeds AMT in a particular year), and which never expire.

For individuals, estates, and trusts, the AMT has a 26% bracket and a 28% bracket, but capital gains and dividends are taxed under the AMT at the highest rate that such items are taxed under the regular income tax. The 26% tax rate applies to the first $182,500 of AMTI (half that amount for married couples filing separately), and the 28% rate applies to AMTI in excess of that amount. For 2017, the AMT exemption amounts for non-corporate taxpayers are $54,300 for single filers, $84,500 for joint filers, $42,250 for married individuals filing separately, and $24,100 for estates and trusts. The AMT exemption amounts begin phasing out at a 25% rate at $160,900 for joint returns, $120,700 for singles, and $80,450 for married individuals filing separately and trusts and estates. These amounts are indexed for inflation.

The corporate AMT rate is 20%, and the exemption amount is $40,000, though corporations with average gross receipts of less than $7.5 million for the preceding three tax years are exempt from the AMT. The exemption amount for corporations phases out at a 25% rate starting at $150,000.

Tax Cuts & Jobs Act Changes:

Individual AMT: The Act retains the alternative minimum tax (AMT) for individuals but, temporarily increases both the exemption amount and the exemption amount phaseout thresholds for the individual AMT. Under the provision, for taxable years beginning after December 31, 2017, and beginning before January 1, 2026, the AMT exemption amount is increased to $109,400 for married taxpayers filing a joint return (half this amount for married taxpayers filing a separate return), and $70,300 for all other taxpayers (other than estates and trusts).

The phaseout thresholds are increased to $1,000,000 for married taxpayers filing a joint return, and $500,000 for all other taxpayers (other than estates and trusts). These amounts are indexed for inflation.

Corporate AMT: The corporate AMT is repealed.

Effective date: The provision would generally be effective for tax years beginning after 2017.

New Inflation Adjustment

Prior or Existing Law: Many parameters of the tax system are adjusted for inflation to protect taxpayers from the effects of rising prices. Most of the adjustments are based on annual changes in the level of the Consumer Price Index for All Urban Consumers ("CPI-U"). The CPI-U is an index that measures prices paid by typical urban consumers on a broad range of products and is developed and published by the Department of Labor.

Tax Cuts & Jobs Act Changes: The Act requires the use of the Chained Consumer Price Index for All Urban Consumers ("C-CPI-U") to adjust tax parameters currently indexed by the CPI-U. The C-CPI-U differs from the CPI-U in accounting for the ability of individuals to alter their consumption patterns in response to relative price changes.

Effective date: The change requiring C-CPI-U indexing after 2017 is permanent.

Business Income of Individuals - 20% Deduction

Prior or Existing Law: Businesses organized as sole proprietorships, partnerships, limited liability companies, and S corporations are generally treated for Federal income tax purposes as "pass-through" entities subject to tax at the individual owner or shareholder level rather than the entity level.

Tax Cuts & Jobs Act Changes: Sole proprietors, S corporation shareholders, and partners in a partnership will be entitled to a deduction equal to 20% of their allocable share of business income (§199A). However, there are several limitations, including:

(1) the deduction cannot generally exceed 50% of the taxpayer's share of the W-2 wages paid by the business or, in the alternative, 25% of the taxpayer's share of the W-2 wages paid by the business, plus 2.5% of the unadjusted basis (the original purchase price) of property used in the production of income, *and*

> **Note:** The W-2 limitations do not apply if a taxpayer earns less than $157,500 (if single; $315,000 if married filing jointly).

(2) certain personal service businesses (i.e., accountants, doctors, lawyers, etc.) are not eligible for the deduction unless their taxable income is less than $157,500 (if single; $315,000) if married.

> **Note:** The deduction does not reduce adjusted gross income.

Effective date: The changes apply to taxable years beginning after 2017, and beginning before 2026.

Child Tax Credit (Enhanced) & Family Tax Credit (New)

Prior or Existing Law: An individual may claim a tax credit for each qualifying child under the age of 17. The amount of the credit per child is $1,000. The aggregate amount of child credits that may be claimed is phased out by $50 for each $1,000 of AGI over $75,000 for single filers and $110,000 for joint filers (§24). Neither the $1,000 credit amount nor the AGI thresholds are indexed for inflation. The taxpayer must submit a valid taxpayer identification number (TIN) for each child for whom the credit is claimed.

To the extent the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit, or ACTC) equal to 15% of earned income in excess of $3,000. The taxpayer is not required to have a Social Security number (SSN) to claim the refundable portion of the credit.

Tax Cuts & Jobs Act Changes: The child credit is increased to $2,000 per qualifying child and the maximum refundable amount of the credit is increased from $1,100 to $1,400. The credit is further modified to temporarily provide for a $500 nonrefundable credit for qualifying dependents other than qualifying children, such as an elderly parent.

The phase-out for the combined child credit, the non-child dependent credit, and the credit for other taxpayers would be increased from $110,000 (for joint filers) under current law to $400,000 (for joint filers), and from $75,000 (for single filers) to $200,000 (for single filers). This increase in the phase-out would eliminate the marriage penalty in the credit.

> **Note:** Taxpayers are required to provide a Social Security number (SSN) to claim the refundable portion of the credit.

Effective date: The changes apply to taxable years beginning after 2017, and beginning before 2026.

Limitation on Non-corporate Losses

Prior or Existing Law: The passive loss rules limit deductions and credits from passive trade or business activities (§469). Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income. Deductions and credits that are suspended under these rules are carried forward and treated as deductions and credits from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer makes a taxable disposition of his entire interest in the passive activity to an unrelated person.

A limitation on excess farm losses applies to taxpayers other than C corporations (§461). If a taxpayer other than a C corporation receives an applicable subsidy for the taxable year, the amount of the excess farm loss is not allowed for the taxable year and is carried forward and treated as a deduction attributable to farming businesses in the next taxable year.

Tax Cuts & Jobs Act Changes: Excess business losses of a taxpayer (other than a corporation) are not allowed for the taxable year. Such losses are carried forward and treated as part of the taxpayer's net operating loss ("NOL") carryforward in subsequent taxable years. NOL carryovers generally are allowed for a taxable year up to the lesser of the carryover amount or 80% (since 2018) of taxable income determined without regard to the deduction for NOLs.

An *excess business loss* is the excess of aggregate deductions of the taxpayer attributable to trades or businesses of the taxpayer (determined without regard to the limitation of the provision), over the sum of aggregate gross income or gain of the taxpayer plus $250,000 (indexed for inflation).

In the case of a partnership or S corporation, the provision applies at the partner or shareholder level.

The provision applies after the application of the passive loss rules.

Education Incentives

Effective date: The changes apply to taxable years beginning after 2017, and beginning before 2026.

There are 15 different tax benefits relating to education that often overlap with one another. Education tax benefits are so complicated that they are ineffective because many taxpayers cannot determine the tax benefits for which they are eligible. In fact, the IRS publication on tax benefits for education is almost 90 pages long.

Education Savings Rules Modified

Prior or Existing Law:

Coverdell Accounts - §530: Income earned by Coverdell education savings accounts, which are established for the purpose of paying qualified education expenses of a named beneficiary, is exempt from tax. Contributions are not deductible and may not exceed $2,000 per beneficiary annually, and may not be made after the designated beneficiary reaches age 18 (except in the case of a special needs beneficiary). The contribution limit is phased out for contributors with modified adjusted gross income between $95,000 and $110,000 ($190,000 and $220,000 for married taxpayers filing a joint return). Distributions from a Coverdell account are excludable from the gross income of the beneficiary if used to pay for qualified education expenses. Qualified education expenses include qualified higher education expenses and qualified elementary and secondary school expenses for attendance in *kindergarten through grade 12*.

Qualified Tuition Program - §529: A qualified tuition program is a program established and maintained by a State or agency or instrumentality thereof, under which a person may make cash contributions to an account that is established for the purpose of satisfying the *qualified higher education expenses* of the designated beneficiary of the account, provided it satisfies certain specified requirements. Contributions are not tax deductible but, are treated as a completed gift eligible for the gift tax annual exclusion. Amounts in the account accumulate on a tax-free basis and qualified distributions are exempt from tax.

Tax Cuts & Jobs Act Changes: The Act modifies §529 plans to allow such plans to distribute not more than $10,000 in expenses for tuition incurred during the taxable year in connection with the enrollment or attendance of the designated beneficiary at a public, private or religious *elementary or secondary school*. This limitation applies on a per-student basis, rather than a per-account basis.

> **Note:** Thus, under the provision, although an individual may be the designated beneficiary of multiple accounts, that individual may receive a maximum of $10,000 in distributions free of tax, regardless of whether the funds are distributed from multiple accounts.

Any excess distributions received by the individual would be treated as a distribution subject to tax under the general rules of §529.

The provision also modifies the definition of higher education expenses to include certain expenses incurred in connection with a *homeschool*. Those expenses are:

(1) curriculum and curricular materials;

(2) books or other instructional materials;

(3) online educational materials;

(4) tuition for tutoring or educational classes outside of the home (but only if the tutor or instructor is not related to the student);

(5) dual enrollment in an institution of higher education; *and*

(6) educational therapies for students with disabilities.

Effective date: The changes apply to taxable years beginning after 2017.

Discharge Of Student Loan Indebtedness Expanded

Prior or Existing Law: Any debt that is forgiven constitutes income. That includes student loans, even if such loans are forgiven on account of death or disability. Under an exception to this general rule, gross income does not include any amount from the forgiveness (in whole or in part) of certain student loans, provided that the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers (§108).

Tax Cuts & Jobs Act Changes: The Act modifies the exclusion of student loan discharges from gross income, by including within the exclusion certain discharges on account of death or disability. Loans eligible for the exclusion under the provision are loans made by:

(1) the United States (or an instrumentality or agency thereof),

(2) a State (or any political subdivision thereof),

(3) certain tax-exempt public benefit corporations that control a State, county, or municipal hospital and whose employees have been deemed to be public employees under State law,

(4) an educational organization that originally received the funds from which the loan was made from the United States, a State, or a tax-exempt public benefit corporation, *or*

(5) private education loans (for this purpose, private education loan is defined in §140(7) of the Consumer Protection Act).

Under the provision, the discharge of a loan as described above is excluded from gross income if the discharge was pursuant to the death or total and permanent disability of the student. Additionally, the provision modifies the gross income exclusion for amounts received under the National Health Service Corps loan repayment program.

Effective date: These changes apply to taxable years beginning after 2017, and beginning before 2026.

Rollovers Between §529 Tuition & ABLE Programs

Prior or Existing Law: A qualified ABLE program is a tax-favored savings program established and maintained by a State or agency or instrumentality thereof intended to benefit individuals with qualified disability expenses (§529A) Contributions to an ABLE account must be made in cash and are not deductible. However, a qualified ABLE program is generally exempt from income tax but is otherwise subject to the taxes imposed on the unrelated business income of tax-exempt organizations. The account may not receive aggregate contributions during any taxable year in excess of the annual gift tax exclusion. Distributions for qualified disability expenses are excludable from income.

Tax Cuts & Jobs Act Changes: The Act allows amounts from §529 qualified tuition programs to be rolled over to an ABLE account without penalty, provided that the ABLE account is owned by the designated beneficiary of that §529 account or a member of such designated beneficiary's family. However, such rolled-over amounts count towards the overall limitation on amounts that can be contributed to an ABLE account within a taxable year. Any amount rolled over that is in excess of this limitation shall be includible in the gross income of the distributee in a manner provided by §72.

Effective date: The change applies to distributions after the date of enactment.

ABLE Account Contributions Modified

Prior or Existing Law: Except in the case of a rollover contribution from another ABLE account, an ABLE account must provide that it may not receive aggregate contributions during a taxable year in excess of the amount under §2503(b) of the Code (the annual gift tax exemption). Additionally, a qualified ABLE program must provide adequate safeguards to ensure that ABLE account contributions do not exceed the limit imposed on accounts under the qualified tuition program of the State maintaining the qualified ABLE program (§529A).

Tax Cuts & Jobs Act Changes: The Act temporarily increases the contribution limitation to ABLE accounts under certain circumstances. While the general overall limitation on contributions (the per-donee annual gift tax exclusion) remains the same, the limitation is temporarily increased with respect to contributions made by the designated beneficiary of the ABLE account. Under the temporary provision, after the overall limitation on contributions is reached, an ABLE account's designated beneficiary may contribute an additional amount, up to the lesser of:

(a) the Federal poverty line for a one-person household; *or*
(b) the individual's compensation for the taxable year.

Additionally, the provision temporarily allows a designated beneficiary of an ABLE account to claim the saver's credit for contributions made to his or her ABLE account.

Deductions

Effective date: The change applies to distributions after the date of enactment and beginning before 2026.

Overall Limitation On Itemized Deductions Repealed

Prior or Existing Law: The total amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, and casualty, theft, or wagering losses) is limited for certain upper-income taxpayers (sometimes referred to as the "Pease limitation"). This limitation applies on top of any other limitations applicable to such deductions (§68). Under the Pease limitation, the otherwise allowable total amount of itemized deductions is reduced by 3% of the amount by which the taxpayer's adjusted gross income exceeds a threshold amount. The Pease limitation does not reduce itemized deductions by more than 80%.

Tax Cuts & Jobs Act Changes: The overall limitation on itemized deductions is repealed.

Effective date: The change applies to taxable years beginning after 2017, and beginning before 2026.

Mortgage Interest Limited

Prior or Existing Law: A taxpayer may claim an itemized deduction for mortgage interest paid with respect to a principal residence and one other residence of the taxpayer. Itemizers may deduct interest payments on up to $1 million in acquisition indebtedness (for acquiring, constructing, or substantially improving a residence), and up to $100,000 in home equity indebtedness (§163(h)). Under the alternative minimum tax (AMT), however, the deduction for home equity indebtedness is disallowed.

Tax Cuts & Jobs Act Changes: In the case of taxable years beginning after December 31, 2017, and beginning before January 1, 2026, a taxpayer may treat no more than $750,000 as acquisition indebtedness ($375,000 in the case of married taxpayers filing separately).

In the case of acquisition indebtedness incurred before December 15, 2017, this limitation is $1,000,000 ($500,000 in the case of married taxpayers filing separately).

For taxable years beginning after December 31, 2025, a taxpayer may treat up to $1,000,000 ($500,000 in the case of married taxpayers filing separately) of indebtedness as acquisition indebtedness, regardless of when the indebtedness was incurred.

Additionally, the Act suspends the deduction for interest on home equity indebtedness. Thus, for taxable years beginning after December 31, 2017, a taxpayer may not claim a deduction for interest on home equity indebtedness. The suspension ends for taxable years beginning after December 31, 2025.

Effective date: The change applies to taxable years beginning after 2017, and beginning before 2026.

State & Local Taxes (SALT) Limited

Prior or Existing Law: An individual may claim an itemized deduction for State and local government income and property taxes paid (§164). In lieu of the itemized deduction for State and local income taxes, individuals may claim an itemized deduction for State and local government sales taxes.

Property taxes may be allowed as a deduction in computing adjusted gross income if incurred in connection with property used in a trade or business; otherwise, they are an itemized deduction. In the case of State and local income taxes, the deduction is an itemized deduction notwithstanding that the tax may be imposed on profits from a trade or business.

In determining a taxpayer's alternative minimum taxable income, no itemized deduction for property, income, or sales tax is allowed.

Tax Cuts & Jobs Act Changes: Unless paid or accrued in carrying on a trade or business, or an activity described in §212 (relating to expenses for the production of income), individuals are *not* allowed an itemized deduction for State and local:

(1) income

(2) sales taxes, or

(3) property taxes.

> **Note:** Thus, the Act allows only those deductions for State, local, and foreign property taxes, and sales taxes, that are presently deductible in computing income on an individual's Schedule C, Schedule E, or Schedule F on such individual's tax return. Thus, for instance, in the case of property taxes, an individual may deduct such items only if these taxes were imposed on business assets (such as residential rental property).

Exception: A taxpayer may claim an itemized deduction of up to $10,000 ($5,000 for a married taxpayer filing a separate return) for the aggregate of

(i) State and local property taxes not paid or accrued in carrying on a trade or business, or an activity described in §212, *and*

(ii) State and local income, war profits, and excess profits taxes (or sales taxes in lieu of income, etc. taxes) paid or accrued in the taxable year.

However, foreign real property taxes may not be deducted under this exception.

Note: An individual may not claim an itemized deduction in 2017 on a pre-payment of income tax for a future taxable year in order to avoid the dollar limitation applicable for taxable years beginning after 2017.

Effective date: The above rules apply to taxable years beginning after 2017, and beginning before 2026.

Personal Casualty Losses Repealed

Prior or Existing Law: A taxpayer may generally claim a deduction for any loss sustained during the taxable year, not compensated by insurance or otherwise. For individual taxpayers, deductible losses must be incurred in a trade or business or other profit-seeking activity or consist of property losses arising from fire, storm, shipwreck, or other casualty, or from theft. Personal casualty or theft losses are deductible only if they exceed $100 per casualty or theft. In addition, aggregate net casualty and theft losses are deductible only to the extent they exceed 10% of an individual taxpayer's adjusted gross income (§165).

Tax Cuts & Jobs Act Changes: The deduction for personal casualty losses would generally be repealed. A taxpayer may claim a personal casualty loss (subject to §165) only if such loss was attributable to a disaster declared by the President under §401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

Effective date: The above rules apply to taxable years beginning after 2017, and beginning before 2026.

Wagering Losses Limited

Prior or Existing Law: A taxpayer may claim an itemized deduction for losses from gambling, but only to the extent of gambling winnings. However, taxpayers may claim other deductions connected to gambling that are deductible regardless of gambling winnings.

Tax Cuts & Jobs Act Changes: All deductions for expenses incurred in carrying out wagering transactions (not just gambling losses) are limited to the extent of wagering winnings.

Note: The change clarifies that the limitation on losses from wagering transactions applies not only to the actual costs of wagers incurred by an individual but to other expenses incurred by the individual in connection with the conduct of that individual's gambling activity. For instance, an individual's otherwise deductible expenses in traveling to or from a casino are subject to the limitation under §165(d).

Effective date: The change applies to taxable years beginning after 2017, and beginning before 2026.

Charitable Contributions Modified

Prior or Existing Law: A taxpayer may claim an itemized deduction for charitable contributions (§170). To be eligible, a contribution must be made by the last day of the tax year for which a return is filed. Thus, for a calendar year taxpayer, a contribution must be made on or before December 31 to be included on a tax return for that tax year, which must be filed by April 15 of the following year.

A charitable contribution deduction is limited to a certain percentage of the individual's adjusted gross income (AGI). The AGI limitation varies depending on the type of property contributed and the type of exempt organization receiving the property. In general, cash contributed to public charities, private operating foundations, and certain non-operating private foundations may be deducted up to 50% of the donor's AGI. Contributions that do not qualify for the 50% limitation (e.g ., contributions to private foundations) may be deducted up to the lesser of:

(1) 30% of AGI, *or*

(2) the excess of the 50%-of-AGI limitation for the tax year over the amount of charitable contributions subject to the 30% limitation.

Capital gain (i.e ., appreciated) property contributed to public charities, private operating foundations, and certain non-operating private foundations may be deducted up to 30% of AGI. Capital gain property contributed to non-operating private foundations may be deducted up to the lesser of:

(1) 20% of AGI, *or*

(2) the excess of the 30%-of-AGI limitation over the amount of property subject to the 30% limitation for contributions of capital gain property.

If an individual contributes more than the applicable AGI limits, the excess contribution generally may be carried over and deducted in the following five tax years, or 15 years in the case of qualified conservation contributions.

In general, a charitable deduction is disallowed to the extent a taxpayer receives a benefit in return. A special rule, however, permits taxpayers to deduct as a charitable contribution 80% of the value of a contribution made to an educational institution to secure the right to purchase tickets for seating at an athletic event in a stadium at that institution.

When computing the deduction for a charitable contribution in the form of use of a passenger vehicle, a taxpayer is generally allowed to claim a standard rate of 14 cents per mile.

In certain cases, the charitable contribution deduction is subject to special rules. In general, a deduction is allowed for a contribution of $250 or more only if the taxpayer provides a contemporaneous written acknowledgment by the organization to which the contribution is made, meeting certain informational requirements. However, this requirement is waived if the donee organization files a return including the information otherwise required.

Tax Cuts & Jobs Act Changes: Several changes are made to the rules applicable to charitable contributions:

AGI Percentage for Cash Contributions Increased

The 50% limitation for cash contributions to public charities and certain private foundations is increased to 60%. The 5-year carryover period is retained to the extent that the contribution amount exceeds 60% of the donor's AGI.

College Athletic Event Seating Rights Repealed

The special rule that provides a charitable deduction of 80% of the amount paid for the right to purchase tickets for athletic events is repealed.

Substantiation Exception for Donee Reported Contributions Repealed

The exception that relieves a taxpayer from providing a contemporaneous written acknowledgment by the donee organization for contributions of $250 or more when the donee organization files a return with the required information is repealed.

Effective date: The provisions that increase the charitable contribution percentage limit and deny a deduction for stadium seating payments are effective for contributions made in taxable years beginning after 2017. The provision that repeals the substantiation exception for certain contributions reported by the donee organization is effective for contributions made in taxable years beginning after 2016.

Section 1 – Review Questions

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

1. In 2020, Mary earned $40,000. What is Mary's marginal income tax rate if she files as head of household?
   a. 12%.
   b. 22%.
   c. 24%.
   d. 32%.

2. A taxpayer's filing requirement, standard deduction, and tax rate are determined by his or her filing status. What is the filing status of an unmarried taxpayer?
   a. separate or individual.
   b. single or head of household.
   c. single or domestic partner.
   d. living together or head of household.

3. Parents can take advantage of numerous child-related credits. Which credit is available to certain taxpayers based on having a qualifying child under age 17?
   a. lifetime learning credit.
   b. child tax credit.
   c. Hope credit.
   d. adoption credit.

4. An education savings account (ESA) is a trust or custodial account established to pay for a named beneficiary's qualified education expenses. Under §530, why should someone contribute to a Coverdell ESA?

   a. Beneficiaries will not owe tax on any withdrawals.

   b. Individuals can make deductible contributions to the account.

   c. Until the beneficiary withdraws from the account, earnings grow free of tax.

   d. The individual can contribute any amount, with no limit.

5. A charitable contribution deduction is limited to a certain percentage of the individual's adjusted gross income (AGI). If an individual contributes more than the applicable AGI limits:

   a. the excess contribution can be carried forward.

   b. the excess is disallowed.

   c. a contemporaneous written acknowledgment will be required.

   d. the taxpayer can request an increase in the AGI limitation.

Itemized Deductions Subject to 2% Floor Fully Denied

Prior or Existing Law: Itemized deductions for certain miscellaneous expenses cannot be deduced unless, in aggregate, they exceed 2% of the taxpayer's adjusted gross income (§§62, 67 & 212). The following deductions are subject to this aggregate 2% floor:

(1) expenses for the production or collection of income (§212), such as:

(a) appraisal fees for a casualty loss or charitable contribution;

(b) casualty and theft losses from property used in performing services as an employee;

(c) clerical help and office rent in caring for investments;

(d) depreciation on home computers used for investments;

(e) excess deductions (including administrative expenses) allowed a beneficiary upon termination of an estate or trust;

(f) fees to collect interest and dividends;

(g) hobby expenses, but generally not more than hobby income;

(h) indirect miscellaneous deductions from pass-through entities;

(i) investment fees and expenses;

(j) loss on deposits in an insolvent or bankrupt financial institution;

(k) loss on traditional IRAs or Roth IRAs, when all amounts have been distributed;

(l) repayments of income;

(m) safe deposit box rental fees, except for storing jewelry and other personal effects;

(n) service charges on dividend reinvestment plans; *and*

(o) trustee's fees for an IRA, if separately billed and paid,

(2) tax preparation expenses (§212),

(3) unreimbursed expenses attributable to the trade or business of being an employee (§§62 & 67), such as:

(a) business bad debt of an employee;

(b) business liability insurance premiums;

(c) damages paid to a former employer for breach of an employment contract;

(d) depreciation on a computer a taxpayer's employer requires him to use in his work;

(e) dues to a chamber of commerce if membership helps the taxpayer perform his job;

(f) dues to professional societies;

(g) educator expenses (except for special $250 above the line deduction);

(h) home office or part of a taxpayer's home used regularly and exclusively in the taxpayer's work;

(i) job search expenses in the taxpayer's present occupation;

(j) laboratory breakage fees;

(k) legal fees related to the taxpayer's job;

(l) licenses and regulatory fees;

(m) malpractice insurance premiums;

(n) medical examinations required by an employer;

(o) occupational taxes;

(p) passport fees for a business trip;

(q) repayment of an income aid payment received under an employer's plan;

(r) research expenses of a college professor;

(s) rural mail carriers' vehicle expenses;

(t) subscriptions to professional journals and trade magazines related to the taxpayer's work;

(u) tools and supplies used in the taxpayer's work;

(v) purchase of travel, transportation, meals, entertainment, gifts, and local lodging related to the taxpayer's work;

(w) union dues and expenses;

(x) work clothes and uniforms if required and not suitable for everyday use; *and*

(y) work-related education, and

(4) other miscellaneous itemized deductions, such as:

(a) repayments of income received under a claim of right (only subject to the 2% floor if less than $3,000);

(b) repayments of Social Security benefits; *and*

(c) the share of deductible investment expenses from pass-through entities.

Tax Cuts & Jobs Act Changes: The Act suspends all miscellaneous itemized deductions that are subject to the 2% floor under present law. Thus, under the provision, taxpayers may not claim the above-listed items as itemized deductions for the taxable years to which the suspension applies.

Effective date: The change applies to taxable years beginning after 2017, and beginning before 2026.

Medical Expense Deduction Temporarily Returned to 7.5%

Prior or Existing Law: A taxpayer may claim an itemized deduction for out-of-pocket medical expenses of the taxpayer, a spouse, or a dependent. This deduction is allowed only to the extent the expenses exceed 10% of the taxpayer's adjusted gross income.

Tax Cuts & Jobs Act Changes: For taxable years beginning after December 31, 2016 and ending before January 1, 2019, the threshold for deducting medical expenses is 7.5% for all taxpayers. For these years, this threshold applies for purposes of the AMT in addition to the regular tax.

Effective date: The change is effective for 2017 and 2018.

Alimony Payment Deduction Repealed

Prior or Existing Law: Alimony payments generally are an above-the-line deduction for the payor and included in the income of the payee. However, alimony payments are not deductible by the payor or includible in the income of the payee if designated as such by the divorce decree or separation agreement (§§61,71 & 215). Child support payments are not treated as alimony

Tax Cuts & Jobs Act Changes: Alimony payments are not deductible by the payor or includible in the income of the payee.

Effective date: The change is effective for any divorce or separation instrument executed after 2018, or for any divorce or separation instrument executed before 2019, and modified after that date if the modification expressly provides that the amendments made by the Act apply to such modification.

Deduction For Moving Expenses Repealed

Prior or Existing Law: A taxpayer may claim a deduction for moving expenses incurred in connection with starting a new job, regardless of whether or not the taxpayer itemizes his deductions. To qualify, the new workplace generally must be at least 50 miles farther from the former residence than the former place of work or, if the taxpayer had no former workplace, at least 50 miles from the former residence (§217).

Tax Cuts & Jobs Act Changes: The Act suspends the deduction for moving expenses for taxable years 2018 through 2025. However, during that suspension period, the provision retains the deduction for moving expenses and the rules providing for exclusions of amounts attributable to in-kind moving and storage expenses (and reimbursements or allowances for these expenses) for members of the Armed Forces (or their spouse or dependents) on active duty that move pursuant to a military order and incident to a permanent change of station.

Exclusions

Effective date: The change applies to taxable years beginning after 2017, and beginning before 2026.

Bicycle Commuting Reimbursement Suspended

Prior or Existing Law: Qualified bicycle commuting reimbursements of up to $20 per qualifying bicycle commuting month are excludable from an employee's gross income (§132). A qualifying bicycle commuting month is any month during which the employee regularly uses the bicycle for a substantial portion of travel to a place of employment and during which the employee does not receive transportation in a commuter highway vehicle, a transit pass, or qualified parking from an employer.

Tax Cuts & Jobs Act Changes: The Act suspends the exclusion from gross income and wages for qualified bicycle commuting reimbursements.

Effective date: The change applies to taxable years beginning after 2017, and beginning before 2026.

Employee Achievement Awards Exclusion Modified

Prior or Existing Law: Employee achievement awards are excluded from employees' income (§§74 & 274). To qualify for the tax exclusion, an employee achievement award must be given in recognition of the employee's length of service or safety achievement at a ceremony that is a meaningful presentation. Furthermore, the conditions and circumstances cannot suggest a significant likelihood that the payment is disguised compensation. The employee is taxed to the extent that the cost (or value, if greater) of the award exceeds the employer's deduction for the award. The employer's deduction for employee achievement awards for any employee in any year cannot exceed $1,600 for qualified plan awards and $400 otherwise. A qualified plan award is an employee achievement award that is part of an established written program of the employer, which does not discriminate in favor of highly compensated employees. In addition, the average award (not counting those of nominal value) may not exceed $400.

Tax Cuts & Jobs Act Changes: The Act adds a definition of "tangible personal property" that may be considered a deductible employee achievement award. It provides that tangible personal property shall not include cash, cash equivalents, gift cards, gift coupons or gift certificates (other than arrangements conferring only the right to select and receive tangible personal property from a limited array of such items pre-selected or pre-approved by the employer), or vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items. No inference is intended that this is a change from present law and guidance.

Effective date: The change is effective for tax years beginning after 2017.

Moving Expense Reimbursement Exclusion Repealed

Prior or Existing Law: Qualified moving expense reimbursements provided by an employer to an employee are excluded from the employee's income. Qualified moving expenses are payments received by an individual from an employer as a payment for or reimbursement of expenses by an employee that would be deductible as moving expenses under §217 if directly paid or incurred by the individual.

Tax Cuts & Jobs Act Changes: The Act repeals the exclusion from gross income and wages for qualified moving expense reimbursements except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order.

Effective date: The change applies to taxable years beginning after 2017, and beginning before 2026.

Savings, Pensions, and Retirement

Special Roth IRA Recharacterization Repealed

Prior or Existing Law: An individual may re-characterize a contribution to a traditional IRA as a contribution to a Roth IRA (and vice versa). An individual may also re-characterize a conversion of a traditional IRA to a Roth IRA (§408A). The deadline for re-characterization generally is October 15 of the year following the conversion. When a re-characterization occurs, the individual is treated for tax purposes as not having made the conversion. The recharacterization must include any net earnings related to the conversion.

Tax Cuts & Jobs Act Changes: The Act repeals the special rule that allows a contribution to one type of IRA to be recharacterized as a contribution to the other type of IRA does not apply to a conversion contribution to a Roth IRA. Thus, recharacterization cannot be used to unwind a Roth conversion. However, recharacterization is still permitted with respect to other contributions. For example, an individual may make a contribution for a year to a Roth IRA and, before the due date for the individual's income tax return for that year, recharacterize it as a contribution to a traditional IRA.

Effective date: The change is effective for tax years beginning after 2017.

Rollover Period For Plan Loan Offset Amounts Extended

Prior or Existing Law: Defined contribution plans are permitted (but not required) to allow plan loans. If the employee fails to abide by the applicable rules, the loan is treated as a taxable distribution that may also be subject to the 10-percent penalty for early withdrawals. If a plan terminates or an employee's employment terminates while a plan loan is outstanding, the employee has 60 days to contribute the loan balance to an individual retirement account (IRA), or the loan is treated as a distribution (§402).

Tax Cuts & Jobs Act Changes: Employees whose plan terminates or who separate from employment while they have plan loans outstanding would have until the due date for filing their tax return for that year to contribute the loan balance to an IRA in order to avoid the loan being taxed as a distribution.

> **Comments:** The provision should help Americans save for retirement by making common-sense reforms to remove harsh rules that often trap individuals and families going through difficult financial circumstances. In addition, the provision overturns the current rule requiring individuals who lose their jobs to roll over any outstanding retirement plan loans to an IRA within 60 days or be subject to taxes and penalties on the loan amount.

Effective date: The change applies to tax years beginning after 2017.

Public Safety Volunteer Service Award Programs Modified

Prior or Existing Law: Special rules apply to deferred compensation plans of State and local government and private, tax-exempt employers. However, an exception to these rules applies in the case of a plan paying solely length of service awards to bona fide volunteers (or their beneficiaries) on account of qualified services performed by the volunteers. For this purpose, qualified services consist of firefighting and fire prevention services, emergency medical services, and ambulance services (§457). The exception applies only if the aggregate amount of length of service awards accruing for a bona fide volunteer with respect to any year of service does not exceed $3,000.

Tax Cuts & Jobs Act Changes: The Act increases the aggregate amount of length of service awards that may accrue for a bona fide volunteer with respect to any year of service to $6,000 and adjusts that amount in $500 increments to reflect changes in cost-of-living for years after the first year the provision is effective. In addition, if the plan is a defined benefit plan, the limit applies to the actuarial present value of the aggregate amount of length of service awards accruing with respect to any year of service.

Estate and Generation-skipping Transfer Taxes

Effective date: The change applies to tax years beginning after 2017.

Prior or Existing Law: Property in an estate is generally subject to a top tax rate of 40% before it passes to the estate's beneficiaries (§2010). When property is transferred during the life of a donor, it is subject to a top gift tax rate of 40%, with the first $14,000 being excluded from the gift tax on a per-donee, annual basis. Additionally, a property that is transferred beyond one generation, whether by bequest or by gift, is subject to an additional generation-skipping tax, also with a top tax rate of 40%. The first $5 million worth of transferred property is exempt from the estate, gift, and generation-skipping taxes, in any combination thereof. This amount is known as the basic exclusion amount and is indexed for inflation ($5.49 million for 2017). Transfers between spouses are excluded from these taxes, and when an individual dies without his or her assets exhausting the basic exclusion amount, any unused basic exclusion amount passes to his or her surviving spouse, with a top basic exclusion amount of $10.98 million for 2017. When a beneficiary receives property from an estate, the beneficiary generally takes a basis in that property equal to its fair-market value at the time the decedent dies, which is known as taking a step-up in basis. However, when a donee receives a gift from a living donor, that donee generally takes the donor's basis in that property, which is known as taking a carryover basis.

Tax Cuts & Jobs Act Changes: The basic (or applicable) exclusion amount is doubled from $5 million (as of 2011) to $10 million. The $10 million amount is indexed for inflation occurring after 2011. As a result, the Federal estate tax exclusion amount is $11.58 million for 2020.

ACA Individual Mandate Repealed

Effective date: The change applies to taxable years beginning after 2017, and beginning before 2026.

Prior or Existing Law: Under the Patient Protection and Affordable Care Act (ACA), individuals must be covered by a health plan that provides at least minimum essential coverage or be subject to a tax (also referred to as a penalty) for failure to maintain the coverage (commonly referred to as the "individual mandate"). The tax is imposed for any month that an individual does not have minimum essential coverage unless the individual qualifies for an exemption (§5000A).

Tax Cuts & Jobs Act Changes: The amount of the individual responsibility payment, enacted as part of the Affordable Care Act, is reduced zero, effectively repealing the mandate or tax.

Effective date: The change is effective for tax years beginning after 2018.

Section 2 – Review Questions

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales

6. Which of the following is included as a miscellaneous itemized deduction under §67?
   a. a deduction for business travel airfares.
   b. impairment-related work expenses.
   c. reimbursed employee business expenses.
   d. unreimbursed employee business expenses, including union dues.

7. The Tax Cut & Jobs Act of 2017 had an impact on estate planning. As a result of this legislation, what happened to the 2020 federal estate tax exclusion amount?
   a. It became $11.58 million.
   b. It returned to $1.5 million.
   c. It was reduced to $2 million.
   d. It became to $3.5 million.

8. The Tax Cut And Jobs Act of 2017 (TCJA) made an important change to the Affordable Care Act (ACA). As a result of the TCJA, who of the following is exempt from the responsibility requirement to maintain minimum essential coverage?
   a. Individuals with income less than 100% of the Federal poverty level.
   b. All individuals.
   c. Employers with more than 50 employees.
   d. All businesses.

Business Taxation

Corporate Tax Rate Reduced to 21%

Prior or Existing Law: A corporation's regular income tax liability generally is determined by applying the following tax rate schedule to its taxable income:

Taxable Income	Tax Rate
Less than $50,000	15%
$50,001 to $75,000	25%
$75,001 to $10,000,000	34%
Over $10,000,000	35%

The 15% and 25% rates are phased out for corporations with taxable income between $100,000 and $335,000. As a result, a corporation with taxable income between $335,000 and $10,000,000 effectively is subject to a flat tax rate of 34%. Similarly, the 34% rate is gradually phased out for corporations with taxable income between $15,000,000 and $18,333,333, such that a corporation with taxable income of $18,333,333 or more effectively is subject to a flat rate of 35% (§11). Thus, the detailed rate chart is:

Taxable Income	Tax Rate
Less than $50,000	15%
$50,001 to $75,000	25%
$75,001 to $100,000	34%
$100,001 to $335,000	39%
$335,001 to $10,000,000	34%
$10,000,001 to $15,000,000	35%
$15,000,001 to $18,333,333	38%
$18,333,334 to Infinity	35%

Personal service corporations are not entitled to use the graduated corporate rates below the 35% rate. A personal service corporation is a corporation the principal activity of which is the performance of personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and such services are substantially performed by the employee-owners.

Corporations are allowed a deduction with respect to dividends received from other taxable domestic corporations. The amount of the deduction is generally equal to 70% of the dividend received. In the case of any dividend received from a 20% owned corporation, the amount of the deduction is equal to 80% of the dividend received. A dividend received from a corporation that is a member of the same affiliated group is generally allowed a deduction equal to 100% (§243).

Tax Cuts & Jobs Act Changes: The Act reduces the corporate tax rate to a flat 21% rate. Personal service corporations are also subject to a flat 21% (not the former 35%) tax rate. In addition, the 70% dividends received deduction is reduced to 50% and the 80% dividends received deduction is reduced to 65%.

Effective date: The change is effective for tax years beginning after 2017.

Additional First Year (Bonus) Depreciation Increased

Prior or Existing Law: Taxpayers may take additional depreciation in the year in which it places certain "qualified property" in service through 2019 (with an additional year for certain qualified property with a longer production period). The amount of this additional depreciation was 50% of the cost of such property placed in service during 2017 and phased down to 40% in 2018 and 30% in 2019. Qualified property that is eligible for this additional depreciation is tangible personal property with a recovery period of 20 years or less under the modified accelerated cost recovery system (MACRS), certain off-the-shelf computer software, water utility property, and qualified improvement property. Certain trees, vines, and plants bearing fruit or nuts are also eligible for this additional depreciation when planted or grafted, rather than when placed in service. Finally, to be eligible for this additional depreciation, the original use of the property must begin with the taxpayer (§168(k)).

> **Note:** Current law allows taxpayers to elect to accelerate the use of their AMT credits in lieu of this additional depreciation.

Tax Cuts & Jobs Act Changes: The additional first-year depreciation deduction is extended and modified through 2026 (through 2027 for longer production period property and certain aircraft). The 50% allowance is increased to 100% for property placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after September 27, 2017, and before January 1, 2023. Thus, the provision repeals the phase-down of the 50% allowance for property placed in service after December 31, 2017, and for specified plants planted or grafted after such date.

> **Note:** The Act also removes the requirement that the original use of qualified property must commence with the taxpayer. Thus, the change applies to purchases of used as well as new items.

However, the 100% allowance is phased down by 20% per calendar year for property placed in service, and specified plants planted or grafted, in taxable years beginning after 2022 (after 2023 for longer production period property and certain aircraft). As a result, the bonus depreciation percentage rates are as follows.

Placed in Service Year	Bonus Depreciation Percentage	
	Qualified Property in General	**Longer Production Period Property and Certain Aircraft**
Portion of Basis of Qualified Property Acquired before Sept. 28.2017		
Sept. 28. 2017-Dec. 31,2017	50 percent	50 percent
2018	40 percent	50 percent
2019	30 percent	40 percent
2020	None	30 percent
2021 and thereafter	None	None
Portion of Basis of Qualified Property Acquired after Sept. 27, 2017		
Sept. 28.2017-Dec. 31,2022	100 percent	100 percent
2023	80 percent	100 percent
2024	60 percent	80 percent
2025	40 percent	60 percent
2026	20 percent	40 percent
2027	None	20 percent
2028 and thereafter	None	None

The Act maintains the §280F increase amount of $8,000 for passenger automobiles placed in service after December 31, 2017.

Effective date: The changes generally apply to property acquired and placed in service after September 27, 2017, and to specified plants planted or grafted after such date. However, a transition rule provides that, for a taxpayer's first taxable year ending after September 27, 2017, the taxpayer may elect to apply a 50% allowance instead of the 100% allowance.

Luxury Automobiles Depreciation Increased

Prior or Existing Law: Section 280F(a) limits the annual cost recovery deduction with respect to certain passenger automobiles. For passenger automobiles that were placed in service in 2017, and for which the additional first-year depreciation deduction under section 168(k) is not claimed, the maximum amount (as indexed for inflation) of allowable depreciation was $3,160 for the year in which the vehicle is placed in service, $5,100 for the second year, $3,050 for the third year, and $1,875 for the fourth and later years in the recovery period. This limitation is indexed for inflation and applies to the aggregate deduction for depreciation and §179 expensing. For passenger automobiles that were eligible for the additional first-year depreciation in 2017, the first-year limitation was increased by an additional $8,000 (§168(k)).

In the case of certain listed property, special and detailed rules apply. No deduction is allowed unless the taxpayer adequately substantiates the expense and business usage of the property (§274).

Tax Cuts & Jobs Act Changes: The Act increases the depreciation limitations under §280F for passenger automobiles placed in service after December 31, 2017, and for which the additional first-year depreciation deduction under section 168(k) is not claimed, the maximum amount of allowable depreciation is $10,000 for the year in which the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years in the recovery period. The limitations are indexed for inflation for passenger automobiles placed in service after 2018.

The provision removes computer or peripheral equipment from the definition of listed property. Such property is therefore not subject to the heightened substantiation requirements that apply to listed property.

Effective date: The changes are effective for property placed in service after 2017, in taxable years ending after such date.

Recovery Period of Certain Farm Property Shortened

Prior or Existing Law: Depreciable assets used in agriculture activities that are assigned a recovery period of 7 years include machinery and equipment, grain bins, and fences (but no other land improvements). Any property (other than nonresidential real property, residential rental property, and trees or vines bearing fruits or nuts) used in a farming business is subject to the 150-percent declining balance method.

Tax Cuts & Jobs Act Changes: The Act shortens the recovery period from 7 to 5 years for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) used in a farming business, the original use of which commences with the taxpayer and is placed in service after 2017. The provision also repeals the required use of the 150% declining balance method for 3-, 5-, 7-, and 10-year property used in a farming business.

Effective date: The change is effective for property placed in service after 2017, in taxable years ending after such date.

Qualified Leasehold & Improvement Property Combined

Prior or Existing Law: Section 168(e)(3)(E) provides a statutory 15-year recovery period for separately defined:

- **(1)** qualified leasehold improvement property,
- **(2)** qualified restaurant, and
- **(3)** qualified retail improvement property

Tax Cuts & Jobs Act Changes: The Act eliminates the separate definitions of qualified leasehold improvement, qualified restaurant, and qualified retail improvement property, and provides a general 15-year recovery period for qualified improvement property.

> **Note:** The Act maintains the general MACRS recovery periods of 39 and 27.5 years for nonresidential real and residential rental property, respectively.

Effective date: The change is effective for property placed in service after 2017.

10 Year ADS for Electing Farming Businesses

Prior or Existing Law: Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period, and convention. However, under a special accounting rule (§263A(d)(3)), certain taxpayers engaged in the business of farming who elect to deduct preproductive period expenditures under the uniform capitalization rules are required to depreciate all farming assets using the alternative depreciation system ("ADS").

Tax Cuts & Jobs Act Changes: The Act requires an electing farming business, i.e., a farming business electing out of the limitation on the deduction for interest, to use ADS to depreciate any property with a recovery period of 10 years or more (e.g., property such as single purpose agricultural or horticultural structures, trees or vines bearing fruit or nuts, farm buildings, and certain land improvements).

Effective date: The change is effective for property placed in service after 2017.

Expensing Under §179 Increased

Prior or Existing Law: Businesses may immediately expense up to $500,000 of the cost of any "section 179 property" placed in service each taxable year. If the business places in service more than $2 million of §179 property in a taxable year, then the amount available for immediate expensing is reduced by the amount by which the cost of such property exceeds $2 million. Further limitations on the ability to immediately expense this amount may apply based on the business's taxable income for the year.

Section 179 property includes tangible personal property with a recovery period of 20 years or less under MACRS, certain off-the-shelf computer software, qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property.

Tax Cuts & Jobs Act Changes: The maximum amount a taxpayer may expense under §179 is increased to $1,000,000, and the phase-out threshold amount is increased to $2,500,000. Thus, the Act makes the maximum amount a taxpayer may expense, for taxable years beginning after 2017, $1,000,000 of the cost of qualifying property placed in service for the taxable year. The $1,000,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2,500,000. The

$1,000,000 and $2,500,000 amounts, as well as the $25,000 sports utility vehicle limitation, are indexed for inflation for taxable years beginning after 2018.

The definition of §179 property is expanded to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging.

The Act also expands the definition of qualified real property eligible for §179 expensing to include any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

Effective date: The changes are effective for tax years beginning after 2017.

Small Business Accounting Methods Expanded

Prior or Existing Law

Cash Method of Accounting: The cash method of accounting generally allows a business to recognize income and deduct expenses when the cash is received or paid, rather than having to accrue income and expense. businesses structured as sole proprietorships, partnerships (without a corporate partner), and S corporations generally may use the cash method of accounting. Businesses structured as corporations and partnerships with a corporate partner may only use the cash method of accounting if its average gross receipts do not exceed $5 million for all prior years (including the prior taxable years of any predecessor of the entity). Farm corporations and farm partnerships with a corporate partner may only use the cash method of accounting if their gross receipts do not exceed $1 million in any year. An exception allows certain family farm corporations to qualify if its gross receipts do not exceed $25 million.

Accounting for Inventories Businesses are required to use an inventory method if the production, purchase, or sale of merchandise is a material income-producing factor to the business. Businesses that are required to use an inventory method must also use the accrual method of accounting for tax purposes. An exception from the accrual method of accounting is provided for certain small businesses with average gross receipts of not more than $1 million, and a second exception is provided for businesses in certain industries (which are not otherwise prohibited from using the cash method) whose annual gross receipts do not exceed $10 million. Businesses that fall within these exceptions may also account for inventory as materials and supplies that are not incidental (i.e ., "non-incidental materials and supplies") under applicable Treasury regulations.

Capitalization & Inclusion of Certain Expenses in Inventory Costs: The uniform capitalization (UNICAP) rules generally require certain direct and indirect costs associated with real or tangible personal property manufactured by a business to be included in either inventory or capitalized into the basis of such property, as applicable. Additionally, for real or personal property acquired by a business for resale, the UNICAP rules generally require certain direct and indirect costs allocable to such property to be included in inventory. a business with $10 million or less of average annual gross receipts is not subject to the UNICAP rules with respect to personal property acquired for resale. This exception to the UNICAP rules does not apply to real and personal property that is manufactured by the business.

Accounting for Long-term Contracts: The taxable income from a long-term contract generally is determined under the percentage-of-completion method, which allows for deductions and income recognition based on the percentage of the contract that is completed each taxable year. A taxpayer determines the percentage of the contract completed during the year by comparing the contract costs that were incurred during the year with the estimated total contract costs.

An exception from the requirement to use the percentage-of-completion method is provided for certain businesses with average annual gross receipts of $10 million or less in the preceding three years. Under this exception, a business may use the completed contract method with respect to contracts that are expected to be completed within a two year period. Under the completed contract method, a business is permitted to deduct costs associated with the construction when they are paid and recognize income when the contract is completed.

Tax Cuts & Jobs Act Changes:

Cash Method of Accounting: The $5 million threshold for corporations and partnerships with a corporate partner is increased to $25 million and the requirement that such businesses satisfy the requirement for all prior years is repealed. The increased $25 million threshold is extended to farm corporations and farm partnerships with a corporate partner, as well as family farm corporations. Also, the average gross receipts test is indexed to inflation.

Accounting for Inventories: Businesses with average gross receipts of $25 million or less are permitted to use the cash method of accounting even if the business has inventories. Under the cash method of accounting, a business may account for inventory as non-incidental materials and supplies. a business with inventories that qualifies for and uses the cash method can for its inventories using its method of accounting reflected on its financial statements or its books and records.

Capitalization & Inclusion of Certain Expenses in Inventory Costs: Businesses with average gross receipts of $25 million or less are fully exempt from the UNICAP rules. This exemption applies to real and personal property acquired or manufactured by such business.

Accounting for Long-term Contracts: The $10 million average gross receipts exception to the percentage-of-completion method is increased to $25 million. Businesses that meet the increased average gross receipts test are permitted to use the completed-contract method (or any other permissible exempt contract method).

> **Comments:** This provision allows businesses greater access to the cash method of accounting, other simplifying accounting method rules, and the exemption from complex UNICAP rules. Additionally, the provision aligns the eligibility to benefits of each of these rules to a single average gross receipts test, which further simplifies these rules for businesses.

Effective date: The changes are effective for tax years beginning after 2017.

S to C Corporate Conversion Rules Modified

Prior or Existing Law: Section 481 prescribes the rules to be followed in computing taxable income in cases where the taxable income of the taxpayer is computed under a different method than the prior year (e.g., when changing from the cash method to an accrual method). In computing taxable income for the year of change, the taxpayer must take into account those adjustments which are determined to be necessary solely by reason of such change in order to prevent items of income or expense from being duplicated or omitted.

Net adjustments that decrease taxable income generally are taken into account entirely in the year of change, and net adjustments that increase taxable income generally are taken into account ratably during the four-taxable-year period beginning with the year of change.

In the case of an S corporation that converts to a C corporation, distributions of cash by the C corporation to its shareholders during a one year post-termination transition period (to the extent of the amount in the accumulated adjustment account) are tax-free to the shareholders and reduce the adjusted basis of the stock (§1371).

Tax Cuts & Jobs Act Changes: Under the Act, 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 an accrual method) is taken into account ratably during the six-taxable-year period beginning with the year of change.

An *eligible terminated S corporation* is any C corporation which:

(1) is an S corporation the day before the enactment,

(2) during the two-year period beginning on the date of such enactment revokes its S corporation election under §1362(a), *and*

(3) all of the owners of which on the date the S corporation election is revoked are the same owners (and in identical proportions) as the owners on the date of such enactment.

Under the provision, in the case of a distribution of money by an eligible terminated S corporation, the accumulated adjustments account shall be allocated to such distribution, and the distribution shall be chargeable to accumulated earnings and profits, in the same ratio as the amount of the accumulated adjustments account bears to the amount the accumulated earnings and profits.

Effective date: The changes are effective upon enactment.

Beneficiaries Of An Electing Small Business Trust

Prior or Existing Law: An electing small business trust ("ESBT") may be a shareholder of an S corporation (§1361). Generally, the eligible beneficiaries of an ESBT include individuals, estates, and certain charitable organizations eligible to hold S corporation stock directly. A nonresident alien individual may not be a shareholder of an S corporation and may not be a potential current beneficiary of an ESBT.

Tax Cuts & Jobs Act Changes: The Act allows a nonresident alien individual to be a potential current beneficiary of an ESBT.

Effective date: The changes are effective for tax years beginning after 2017.

Charitable Deduction for Electing Small Business Trust

Prior or Existing Law: The treatment of a charitable contribution passed through by an S corporation depends on the shareholder. Because an ESBT is a trust, the deduction for charitable contributions applicable to trusts (§642), rather than the deduction applicable to individuals (§170), applies to the trust.

Tax Cuts & Jobs Act Changes: The Act provides that the charitable contribution deduction of an ESBT is not determined by the rules generally applicable to trusts but rather by the rules applicable to individuals. Thus, the percentage limitations and carryforward provisions applicable to individuals apply to charitable contributions made by the portion of an ESBT holding S corporation stock.

Effective date: The changes are effective for tax years beginning after 2017.

Business Interest Limited

Prior or Existing Law: Business interest generally is allowed as a deduction in the taxable year in which the interest is paid or accrued, subject to a number of limitations. For example, limitations on interest expense exist for certain amounts paid in connection with insurance and annuity contracts, while other disallowances exist with respect to interest payments between related taxpayers. Other limitations on the deductibility of interest expense, in general, exist to disallow certain amounts of interest paid in connection with tax-exempt interest, passive interest, investment interest, and qualified residence interest.

Section 163(j) limits the ability of a corporation to deduct disqualified interest (generally, interest paid or accrued to a related party when no Federal income tax is imposed with respect to the interest) paid or accrued in a taxable year if two threshold tests are satisfied:

(1) the payor's debt-to-equity ratio exceeds 1.5 to 1.0 (the safe harbor ratio); *and*

(2) the payor's net interest expense exceeds 50% of its adjusted taxable income.

Generally, adjusted taxable income is the corporation's taxable income computed without regard to deductions for net interest expense, net operating losses, domestic production activities under§199, depreciation, amortization, and depletion. Interest amounts disallowed under these rules can be carried forward indefinitely. In addition, any excess limitation (i.e ., the excess, if any, of 50% of the adjusted taxable income of the payor over the payor's net interest expense) can be carried forward three years.

Tax Cuts & Jobs Act Changes: In the case of any taxpayer for any taxable year, the deduction for business interest is limited to the sum of:

(1) business interest income;

(2) 30% of the adjusted taxable income of the taxpayer for the taxable year; and

(3) the floor plan financing interest of the taxpayer for the taxable year.

> **Definitions:** *Business interest* means any interest paid or accrued on indebtedness properly allocable to a trade or business. *Business interest income* means the amount of interest includible in the gross income of the taxpayer for the taxable year which is properly allocable to a trade or business. *Adjusted taxable income* is a business's taxable income computed without regard to business interest expense, business interest income, net operating losses, and depreciation, amortization, and depletion. *Floor plan financing interest* means interest paid or accrued on floor plan financing indebtedness. Floor plan financing indebtedness means indebtedness used to finance the acquisition of motor vehicles held for sale to retail customers and secured by the inventory so acquired.

The amount of any business interest not allowed as a deduction for any taxable year may be carried forward indefinitely, treating business interest as allowed as a deduction on a first-in, first-out basis.

> **Note:** A taxpayer that meets the $25 million gross-receipts test is exempt from the interest deduction limitation. In addition, the limitation does not apply to any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. Farming businesses are allowed to elect out of the limitation.

The limitation generally applies at the taxpayer level. However, in the case of any partnership, the limitation is applied at the partnership level.

Effective date: The change is effective for tax years beginning after 2017.

Net Operating Loss Deduction Modified

Prior or Existing Law: A net operating loss (NOL) generally is the amount by which a taxpayer's current-year business deductions exceed its current-year gross income. NOLs may not be deducted in the year generated but may be carried back two years and carried forward 20 years to offset taxable income in such years (§172). The alternative minimum tax (AMT) rules provide that a taxpayer's NOL deduction may not reduce the taxpayer's alternative minimum taxable income by more than 90%.

Different rules apply with respect to NOLs arising in certain circumstances. A special five-year carryback applies to NOLs arising from a farming loss, losses arising from certain bad debts of commercial banks, and certain amounts related to disaster relief. Special rules also apply to specified liability losses (ten-year carryback) and excess interest losses (no carryback to any year preceding a corporate equity reduction transaction). Additionally, a special rule applied to losses incurred in 2008 and 2009 (up to a five-year carryback) and a special rule applied to certain electric utility companies with respect to NOLs arising in 2003 through 2005 (five-year carryback).

Tax Cuts & Jobs Act Changes: NOLs are generally not allowed to be carried back (i.e., the 2-year carryback period and the longer carryback periods for special types of losses, are eliminated), but may only be carried forward indefinitely. Exceptions are provided for farming and insurance companies. Farming losses may be carried back 2 years (down from 5) and non-life insurance companies retain 2-year carryback and 20-year carryforward periods.

However, for 2018 and later, Taxpayers can only deduct an NOL carryover or carryback (in the case of farms and insurance companies) to the extent of 80% of the taxpayer's taxable income (determined without regard to the NOL deduction).

Effective date: The changes are effective for tax years beginning after 2017.

Like-kind Exchanges Limited to Real Property

Prior or Existing Law: An exchange of property, like a sale, generally is a taxable transaction. A special rule provides that no gain or loss is recognized to the extent that property held for productive use in the taxpayer's trade or business, or property held for investment purposes, is exchanged for property of a like-kind that also is held for productive use in a trade or business or for investment (§1031). The taxpayer receives a basis in the new property equal to the taxpayer's adjusted basis in the exchanged property. The like-kind exchange rule applies to a wide range of property from real estate to tangible personal property. It does not apply, however, to exchanges of stock in trade or other property held primarily for sale, stocks, bonds, partnership interests, certificates of trust or beneficial interest, other securities or evidences of indebtedness or interest, or to certain exchanges involving livestock or involving foreign property. A like-kind exchange does not require that the properties be exchanged simultaneously - as long as the property to be received in the exchange is identified within 45 days and ultimately received within 180 days of the sale of the original property, gain is deferred.

Tax Cuts & Jobs Act Changes: The special rule allowing deferral of gain on like-kind exchanges is modified to allow for like-kind exchanges only with respect to real property.

> **Comments:** The like-kind exchange rules currently allow taxpayers to defer tax on the built-in gains in property by exchanging it for similar property. With multiple exchanges, gains essentially may be deferred for decades, and ultimately escape taxation entirely if the property's basis is stepped up to its fair market value upon the death of the owner. The Act provides full expensing for most tangible personal property which provides a marginal effective tax rate of zero percent to fully expensed property, equating to the deferral that like-kind exchanges provide currently.

Effective date: The change generally applies to exchanges completed after 2017. However, an exception is provided for any exchange if the property disposed of by the taxpayer in the exchange is disposed of on or before December 31, 2017, or the property received by the taxpayer in the exchange is received on or before such date.

Business Capitalization Clarified

Prior or Existing Law: The gross income of a corporation generally does not include contributions to its capital (i.e., transfers of money or property to the corporation by a non-shareholder such as a government entity). In addition, a corporation does not recognize gain or loss on the receipt of money or property in exchange for stock of the corporation (§118).

Tax Cuts & Jobs Act Changes: The Act does not repeal §118 under which, generally, a corporation's gross income does not include contributions to capital. Rather, it preserves that provision, but provides that the term "contributions to capital" does not include:

(1) any contribution in aid of construction or any other contribution as a customer or potential customer, *and*

(2) any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such).

Effective date: The change is effective for contributions made, and transactions entered into, after the date of enactment. However, the provision shall not apply to any contribution made after the date of enactment by a governmental entity pursuant to a master development plan that has been approved prior to such date by a governmental entity.

Local Lobbying Expenses Deduction Exception Repealed

Prior or Existing Law: Businesses generally may deduct ordinary and necessary expenses paid or incurred in connection with carrying on any trade or business. An exception to the general rule (§162(e)), however, disallows deductions for lobbying and political expenditures with respect to legislation and candidates for office, except for lobbying expenses with respect to legislation before local government bodies (including Indian tribal governments).

Tax Cuts & Jobs Act Changes: Deductions for lobbying expenses with respect to legislation before local government bodies (including Indian tribal governments) are disallowed.

Effective date: The change is effective for amounts paid or incurred after the date of enactment.

Deduction for Domestic Production Activities Repealed

Prior or Existing Law: Taxpayers may claim a deduction equal to 9% (6% in the case of certain oil and gas activities) of the lesser of the taxpayer's qualified production activities income or the taxpayer's taxable income for the tax year (§199). The deduction is limited to 50% of the W-2 wages paid by the taxpayer during the calendar year. Qualified production activities income is equal to domestic production gross receipts less the cost of goods sold and expenses properly allocable to such receipts. Qualifying receipts are derived from property that was manufactured, produced, grown, or extracted within the United States; qualified film productions; production of electricity, natural gas, or potable water; construction activities performed in the United States; and certain engineering or architectural services. Qualifying receipts do not include gross receipts derived from the sale of food or beverages prepared at a retail establishment; the transmission or distribution of electricity, gas, and potable water; or the disposition of land.

Tax Cuts & Jobs Act Changes: The deduction for domestic production activities is repealed

Effective date: The change is effective for non-corporate taxpayers and for certain rules applicable to agricultural and horticultural cooperates for taxable years beginning after 2017. The change is effective for C corporations for taxable years beginning after 2018.

Entertainment Activities Or Facilities Deduction Repealed

Prior or Existing Law: No deduction is allowed for expenses relating to entertainment, amusement or recreation activities, or facilities (including membership dues with respect to such activities or facilities), unless the taxpayer establishes that the item was directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business, in which case the taxpayer may deduct up to 50% of expenses relating to meals and entertainment (§274). An item is considered directly related if it is associated with a substantial and bona fide business discussion.

A taxpayer also may deduct the cost of certain fringe benefits provided to employees (e.g., employee discounts, working condition, and transportation fringe benefits), even though such benefits are excluded from the employee's income under §132. Additionally, a taxpayer may deduct expenses for goods, services, and facilities to the extent that the expenses are reported by the taxpayer as compensation and wages to an employee (or includible in gross income of a recipient who is not an employee).

A taxpayer may deduct certain reimbursed expenses, including reimbursement arrangements in which an employer reimburses the expenses incurred by employees of a subcontractor, provided such expenses are properly substantiated and not treated as income to the employee.

Tax Cuts & Jobs Act Changes: The Act provides that no deduction is allowed with respect to:

(1) an activity generally considered to be entertainment, amusement or recreation,

(2) membership dues with respect to any club organized for business, pleasure, recreation or other social purposes, *or*

(3) a facility or portion thereof used in connection with any of the above items.

Thus, the Act repeals the present-law exception to the deduction disallowance for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business (and the related rule applying a 50% limit to such deductions).

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

> **Comments:** It is difficult for the IRS to determine whether entertainment expenses are directly related to a trade or business, creating uncertainty for taxpayers as well as the potential for significant abuse. The provision aligns the treatment of transportation fringe benefits, benefits in the form of on-premises gyms and other athletic facilities, and amenities provided to an employee that are primarily personal in nature and not directly related to a trade or business with other similar tax items.

Taxpayers may still generally deduct 50% of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel). For amounts incurred and paid after 2017 and before 2025, the Act expands this 50% limitation to expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for de minimis fringes and for the convenience of the employer. Such amounts incurred and paid after 2025 are not deductible.

Effective date: The changes apply to amounts paid or incurred after 2017. However, for expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for *de minimis* fringes and for the convenience of the employer, amounts paid or incurred after 2025 are not deductible.

UBTI Increased by Taxable Fringe Benefits

Prior or Existing Law: Tax-exempt entities are situated similarly to taxable entities with regard to providing their employees with transportation fringe benefits, and on-premises gyms and other athletic facilities, as such benefits pass from the employer to the employee free of tax at both levels (§512). Employers subject to Federal income tax may deduct the costs of such benefits, with tax-exempt entities not needing to deduct the costs of such benefits, and their employees may exclude the values of such benefits from their taxable incomes.

Tax Cuts & Jobs Act Changes: Tax-exempt entities are taxed on the values of providing their employees with transportation fringe benefits, and on-premises gyms and other athletic facilities, by treating the funds used to pay for such benefits as unrelated business taxable income, thus subjecting the values of those employee benefits to a tax equal to the corporate tax rate.

> **Comments:** Treating the non-deductibility of certain employee benefits similarly between tax-exempt entities and taxable entities is necessary for creating parity between the different types of entities so that one does not have an advantage over the other with regard to recruiting and retaining employees.

Effective date: The change is effective for amounts paid or incurred after 2017.

FDIC Premium Deduction Limited

Prior or Existing Law: Amounts paid by insured depository institutions pursuant to an assessment by the Federal Deposit Insurance Corporation (FDIC) to support the Deposit Insurance Fund (DIF) are currently deductible as a trade or business expense (§162).

Tax Cuts & Jobs Act Changes: A percentage of such assessments is non-deductible for institutions with total consolidated assets in excess of $10 billion. The percentage of nondeductible assessments is equal to the ratio that total consolidated assets in excess of $10 billion bears to $40 billion so that assessments are completely non-deductible for institutions with total consolidated assets in excess of $50 billion.

> **Comments:** The provision corrects for the fact that, when the FDIC determines the amount of assessments that are necessary to maintain an adequate balance in the DIF, it does so on a pretax basis and does not take into account the deductibility of the premium payments. These deductions diminish the General Fund and effectively result in a General Fund transfer to the DIF.

Effective date: The change is effective for tax years beginning after 2017.

Securities Rollover Into SSBICs Repealed

Prior or Existing Law: Gain or loss generally is recognized on any sale, exchange, or other disposition of property. A special rule permits an individual or corporation to roll over without recognition of income any capital gain realized on the sale of publicly traded securities when the proceeds are used to purchase common stock or a partnership interest in a specialized small business investment corporation (SSBIC) within 60 days of the sale of the securities (§1044). SSBICs are a special type of investment fund licensed by the U.S. Small Business Administration until 1996 when the program was repealed (though certain existing SSBICs were grandfathered). The amount of gain that a taxpayer may roll over in a tax year is limited to the lesser of:

(1) $50,000 ($250,000 for corporations) *or*

(2) $500,000 ($1,000,000 for corporations) reduced by the gain previously excluded under the provision.

Tax Cuts & Jobs Act Changes: The special rule permitting gains on publicly traded securities to be rolled over to an SSBIC is repealed.

Effective date: The change is effective for sales after 2017.

Self-Created Property Not Capital Asset

Prior or Existing Law: A self-created patent, invention, model or design (whether or not patented), or secret formula or process is treated as a capital asset (§1221). However, the following self-created property is not treated as a capital asset: copyrights; literary, musical or artistic compositions; and letters or memoranda. Any gain or loss recognized as a result of the sale, exchange, or other disposition of such property is generally ordinary in character. The creator of musical compositions or copyrights in musical works, however, may elect to treat such property as a capital asset.

Tax Cuts & Jobs Act Changes: Gain or loss from the disposition of a self-created patent, invention, model or design (whether or not patented), or secret formula or process is ordinary (will not receive capital gain treatment) in character. This is consistent with the treatment of copyrights under current law. In addition, the election to treat musical compositions and copyrights in musical works as a capital asset is repealed.

Effective date: The change is effective for dispositions of such property after 2017.

Technical Termination Of Partnerships Repealed

Prior or Existing Law: A partnership terminates only if:

(1) no part of any business, financial operations, or venture of the partnership continues to be carried on by any of its partners, *or*

(2) within a 12-month period, there is a sale or exchange of 50% or more of the total interests in partnership capital and profits (§704(b)).

The second type of termination is commonly referred to as a technical termination.

When a technical termination occurs, the business of the partnership continues in the same legal form, but the partnership is treated as newly formed and must make new elections for various accounting methods, depreciation lives, and other purposes.

Tax Cuts & Jobs Act Changes: The termination rule is repealed. Thus, the partnership would be treated as continuing even if more than 50% of the total capital and profits interests of the partnership are sold or exchanged, and new elections would not be required or permitted.

The Act does not change the present-law rule of §708(b)(1)(A) that a partnership is considered as terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

Effective date: The change is effective for tax years beginning after 2017.

Increased Holding on Certain Received Profit Interests

Prior or Existing Law: Though courts have differed, in some instances, a taxpayer receiving a *profits* interest for performing services has not been taxed upon the receipt of the partnership interest. In R.P. 93-7 and R.P. 2001-43, the IRS issued guidance as to when the IRS would treat the receipt of a partnership profits interest for services as not a taxable event for the partnership or the partner. By contrast, a partnership *capital* interest received for services is includable in the partner's income under generally applicable rules relating to the receipt of property for the performance of services (§61).

Under §83, if property is transferred for services, the person performing the services must recognize income (fair market value over amount paid) in the year the property is first transferable or not subject to a substantial risk of forfeiture. However, even if the property is nonvested, the service provider may nevertheless elect within 30 days of the transfer to recognize income for the taxable year of the transfer.

Tax Cuts & Jobs Act Changes: The Act treats as short-term capital gain taxed at ordinary income rates the amount of the taxpayer's net long-term capital gain with respect to an applicable partnership interest for the taxable year that exceeds the amount of such gain calculated as if a three-year (not one-year) holding period applies, notwithstanding the rules of §83 or any election.

> **Note:** Thus, the fact that an individual may have included an amount in income upon acquisition of the applicable partnership interest, or that an individual may have made a §83(b) election with respect to an applicable partnership interest, does not change the three-year holding period requirement for long-term capital gain treatment with respect to the applicable partnership interest.

An *applicable partnership interest* is any interest in a partnership that, directly or indirectly, is transferred to (or held by) the taxpayer in connection with the performance of services in any applicable trade or business.

An applicable trade or business means any activity (regardless of whether the activity is conducted in one or more entities) that consists in whole or in part of the following:

(1) raising or returning capital, and either

(2) investing in (or disposing of) specified assets (or identifying specified assets for investing or disposition), *or*

(3) developing specified assets (i.e., securities, commodities, rental and investment real estate, cash, options or derivatives).

Effective date: The change is effective for tax years beginning after 2017.

Built-In Loss Definition On Transfer Of Partnership Interest

Prior or Existing Law: In general, a partnership does not adjust the basis of partnership property following the transfer of a partnership interest unless either the partnership has made a one-time election under §754 to make basis adjustments, or the partnership has a substantial built-in loss immediately after the transfer (§749(a)). A substantial built-in loss exists if the partnership's adjusted basis in its property exceeds by more than $250,000 the fair market value of the partnership property.

Tax Cuts & Jobs Act Changes: The Act modifies the definition of a substantial built-in loss for purposes of §743(d), affecting transfers of partnership interests. Under the provision, in addition to the present-law definition, a substantial built-in loss also exists if the transferee would be allocated a net loss in excess of $250,000 upon a hypothetical disposition by the partnership of all partnership's assets in a fully taxable transaction for cash equal to the assets' fair market value, immediately after the transfer of the partnership interest.

Effective date: The change is effective for tax years beginning after 2017.

Limitation On Allowance Of Partner's Share Of Loss

Prior or Existing Law: A partner's distributive share of partnership loss (including capital loss) is allowed only to the extent of the adjusted basis (before reduction by current year's losses) of the partner's interest in the partnership at the end of the partnership taxable year in which the loss occurred. However, in applying the basis limitation on partner losses, Treasury regulations do not take into account the partner's share of partnership charitable contributions and foreign taxes paid or accrued.

Tax Cuts & Jobs Act Changes: The Act modifies the basis limitation on partner losses to provide that the limitation takes into account a partner's distributive share of partnership charitable contributions (as defined in §170(c)) and taxes (described in §901) paid or accrued to foreign countries and to possessions of the United States. Thus, the amount of the basis limitation on partner losses is decreased to reflect these items.

Effective date: The change is effective for tax years beginning after 2017.

5 Year Amortization of Research & Experimental Expenditures

Prior or Existing Law: Under §174, Taxpayers may:

(1) elect to deduct currently the amount of certain reasonable research or experimentation expenditures paid or incurred in connection with a trade or business (§174(a)),

(2) forgo a current deduction, capitalize their research expenditures, and recover them ratably over the useful life of the research, but in no case over a period of less than 60 months (§174(b), *or*

(3) elect to amortize their research expenditures over a period of 10 years (§174(f)).

Amounts defined as research or experimental expenditures under §174 generally include all costs incurred in the experimental or laboratory sense related to the development or improvement of a product.

Tax Cuts & Jobs Act Changes: Amounts defined as specified research or experimental expenditures are required to be capitalized and amortized ratably over a five-year period (15 years, if conducted outside the U.S.), beginning with the midpoint of the taxable year in which the specified research or experimental expenditures were paid or incurred.

Effective date: The change applies to amounts paid or incurred in taxable years beginning after 2021.

Rules for Taxable Year of Inclusion Expanded

Prior or Existing Law: For an accrual basis taxpayer, an amount is included in gross income when all the events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy (i.e., when the "all events test" is met), unless an exception permits deferral or exclusion, or a special method of accounting applies.

The holder of a debt instrument with original issue discount ("OID") generally accrues and includes the OID in gross income as interest over the term of the instrument, regardless of when the stated interest (if any) is paid.

Tax Cuts & Jobs Act Changes: The Act requires an accrual method taxpayer subject to the all events test for an item of gross income to recognize such income no later than the taxable year in which such income is taken into account as revenue in an applicable financial statement or another financial statement and prescribed by the Secretary. Accrual method taxpayers with an applicable financial statement are directed to apply the income recognition rules under §451 before applying the special rules for OID, market discount on bonds, discounts on short-term obligations, OID on tax-exempt bonds, and stripped bonds and stripped coupons.

The provision also codifies the current deferral method of accounting for advance payments for goods, services, and other specified items provided R.P. 2004-34.

Effective date: The changes apply to taxable years beginning after 2017. In the case of income from a debt instrument having OID, the provision applies to taxable years beginning after 2018.

Denial of Deduction for Certain Fines Expanded

Prior or Existing Law: A deduction is denied for fines or penalties paid to a government for the violation of any law (§162(f)).

Tax Cuts & Jobs Act Changes: The Act denies deductibility for any otherwise deductible amount paid or incurred (whether 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 such government or entity into the potential violation of any law.

Effective date: The change denying the deduction is effective for amounts paid or incurred on or after the date of enactment.

Denial of Deduction for Sexual Harassment Settlements

Prior or Existing Law: A taxpayer generally is allowed a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business (§162).

Tax Cuts & Jobs Act Changes: No deduction is allowed for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if such payments are subject to a nondisclosure agreement (§162(q)).

Effective date: The change is effective for amounts paid or incurred after the date of enactment.

Drug Credit For Rare Diseases Reduced

Prior or Existing Law: A drug manufacturer may claim a credit equal to 50 percent of qualified clinical testing expenses.

Tax Cuts & Jobs Act Changes: The credit for clinical testing expenses for certain drugs for rare diseases or conditions is reduced by 25% of qualified clinical testing expenses.

Effective date: The change is effective for tax years beginning after 2017.

Rehabilitation Credit Modified

Prior or Existing Law: A taxpayer may claim a credit for expenses incurred to rehabilitate old and/or historic buildings. Qualified rehabilitation expenditures generally include reconstruction, renovation, and restoration but, not enlargement or new construction. A 20% credit is allowed for qualified rehabilitation expenditures with respect to a certified historic structure, while a 10% credit is allowed for qualified rehabilitation expenditures with respect to a qualified rehabilitated building (§47). To qualify for the 10% credit, the rehabilitation expenditures during the 24-month period selected by the taxpayer and ending within the tax year must exceed the greater of the adjusted basis of the building (and its structural components) or $5,000.

Tax Cuts & Jobs Act Changes: The Act repeals the 10% credit for pre-1936 buildings but, retains the 20% credit for qualified rehabilitation expenditures with respect to a certified historic structure, with a modification. The credit allowable for a taxable year during the five-year period beginning in the taxable year in which the qualified rehabilitated building is placed in service is an amount equal to the ratable share. The ratable share for a taxable year during the five-year period is an amount equal to 20% of the qualified rehabilitation expenditures for the building, as allocated ratably to each taxable year during the five-year period. It is intended that the sum of the ratable shares for the taxable years during the five-year period does not exceed 100% of the credit for qualified rehabilitation expenditures for the qualified rehabilitated building.

Effective date: Subject to a transition rule, the change is effective for tax years beginning after 2017.

New Credit for Paid Family & Medical Leave

Prior or Existing Law: Tax law does not provide a credit to employers for compensation paid to employees while on leave.

Tax Cuts & Jobs Act Changes: The Act allows eligible employers to claim a general business credit equal to 12.5% of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave (not to exceed 12 weeks for any year) if the rate of payment under the program is 50% of the wages normally paid to an employee (§45S). However, the credit is increased by 0.25 percentage points (but not above 25 percent) for each percentage point by which the rate of payment exceeds 50%.

An *eligible employer* is one who has in place a written policy that allows all qualifying full-time employees not less than two weeks of annual paid family and medical leave, and who allows all less-than-full-time qualifying employees a commensurate amount of leave on a pro-rata basis.

A *qualifying employee* is any employee who has been employed by the employer for one year or more, and who for the preceding year, had compensation, not in excess of 60% of the compensation threshold for highly compensated employees.

Effective date: The section is generally effective for wages paid in 2018.

Section 3 – Review Questions

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

9. Over the years, taxpayers have periodically been allowed to take additional first-year (or bonus) depreciation when certain "qualified property" was placed in service. The Tax Cut And Jobs Act of 2017 (TCJA) modified this additional first-year depreciation by:
   a. decreasing the allowance from 100% to 50%.
   b. extended the phase-down of the 50% allowance.
   c. extending it through 2026.
   d. requiring the original use of property commence with the taxpayer.

10. Subject to a number of limitations, business interest generally is allowed as a deduction in the taxable year in which the interest is paid or accrued. However, the TCJA has modified the deduction of business interest by:
    a. adding additional limitations.
    b. permitting a 10 year carryforward of disallowed business interest.
    c. applying the modification to real property development.
    d. applying a limitation at the partner-level.

11. Section 1031 provides that no gain or loss shall be recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of a like-kind to be held for similar purposes. The TCJA modifies §1031 to disallow the exchange of:
    a. real property for real property.
    b. improved real property for unimproved real property.
    c. personal property for personal property.
    d. raw land for an apartment house.

12. A technical partnership termination can be painful. The partnership is treated as newly formed and must make new elections for various accounting methods, depreciation lives, and other purposes. The TCJA now helps avoid a technical termination by:
    a. repealing the technical termination rule.
    b. increasing the time period in which termination can occur.
    c. having the rule only apply to the sale of capital interests.
    d. having the rule only apply to the sale of profit interests.

13. A partner's distributive share of partnership loss is allowed only to the extent of the adjusted basis of the partner's interest. The TCJA modified the calculation of a partner's basis by:

    a. taking into account a partner's share of charitable contributions.

    b. not taking into account a partner's share of foreign taxes.

    c. decreasing it by the partner's distributive share of taxable income.

    d. increasing it by money distributed to the partner.

14. Taxpayers can apply the §47 tax credit to costs incurred for certain rehabilitation efforts on old and/or historic buildings. The TCJA now repeals the 10% credit for pre-1936 buildings. However, which of the following activities has always been outside the scope of this credit?

    a. enlargement.

    b. reconstruction.

    c. renovation.

    d. restoration.

Bonds

Advance Refunding Bonds Repealed

Prior or Existing Law: A refunding bond is any bond used to pay principal, interest, or redemption price on a prior bond issue (the refunded bond). A current refunding occurs when the refunded bond is redeemed within 90 days of issuance of the refunding bonds. An advance refunding is issued more than 90 days before the redemption of the refunded bond. Interest on current refunding bonds is generally not taxable (§149). Interest on advance refunding bonds is generally not taxable for governmental bonds but is taxable for PABs.

Tax Cuts & Jobs Act Changes: The Act repeals the exclusion from gross income for interest on a bond issued to advance refund another bond. Interest on advance refunding bonds (i.e ., refunding bonds issued more than 90 days before the redemption of the refunded bonds) would be taxable. However, interest on current refunding bonds continues to be tax-exempt.

> **Comments:** Current-law advance refunding bonds provide State and local governments with incentives to issue two sets of Federally subsidized debt to finance the same activity. The provision would not affect the taxation of interest on refunding bonds issued within 90 days of the redemption of the refunded bond.

Effective date: The change is effective for advance refunding bonds issued after 2017.

Tax Credit Bonds Repealed

Prior or Existing Law: State and local governments and other entities may issue various categories of tax credit bonds to finance specific types of projects. Each category of tax credit bond has its own set of rules regarding volume cap, if any, and allocation. Holders of tax credit bonds receive Federal tax credits fully or partially in lieu of interest payments from the issuer, depending on the level of Federal subsidy (§54). For some of these bonds, during 2009 and 2010, issuers had the option of instead issuing taxable bonds and receiving direct payments from the Federal government.

The authority to issue some types of tax credit bonds has expired, and the volume cap to issue some of these bonds has been fully used. There are some types of tax credit bonds for which there is still an outstanding volume cap and issuing authority has not expired.

Insurance

Tax Cuts & Jobs Act Changes: The rules relating to tax credit bonds generally are repealed. Holders and issuers will continue receiving tax credits and payments for tax credit bonds already issued, but no new bonds can be issued.

Effective date: The change is effective for bonds issued after 2017.

Net Operating Losses Of Life Insurance Companies Changed

Prior or Existing Law: Net operating losses of a trade or business generally may be carried back up to two tax years or carried forward up to 20 tax years. In the case of life insurance companies, however, net operating losses may be carried back up to three tax years or carried forward up to 15 tax years (§810).

Tax Cuts & Jobs Act Changes: Life insurance companies are allowed to carry net operating losses back up to two tax years (not three) or forward up to 20 tax years (not 15), in conformity with the general net operating loss carryover rules.

Effective date: The change is effective for losses arising in tax years beginning after 2017.

Small Life Insurance Company Deduction Repealed

Prior or Existing Law: Life insurance companies may deduct 60% of their first $3 million of life insurance-related income. The deduction is phased out for companies with income between $3 million and $15 million. In addition, the deduction is not available to life insurance companies with assets of at least $500 million.

Tax Cuts & Jobs Act Changes: The special deduction for small life insurance companies is repealed.

> **Comments:** The provision eliminates a tax subsidy for businesses in a particular industry that is not available to similar businesses in other industries. Eliminating this subsidy also would remove a tax preference that is provided to the segment of the insurance industry in which the risk distribution benefits of pooling are the weakest.

Effective date: The change is effective for tax years beginning after 2017.

Computation Of Life Insurance Tax Reserves

Prior or Existing Law: Life insurance companies may deduct net increases in life insurance company reserves, while net decreases in such reserves are included in gross income. In computing changes in reserves, the life insurance reserve for a contract generally is the greater of the net surrender value of the contract or the reserve determined under rules provided in the Code, which for discounting purposes employ a prescribed interest rate that is equal to the greater of the applicable Federal rate or the prevailing State assumed interest rate. The "prevailing State assumed interest rate" is equal to the highest assumed interest rate permitted to be used in at least 26 States in computing regulatory life insurance reserves. The discount rate used by property and casualty (P&C) insurance companies for reserves is the average applicable Federal mid-term rate over the 60 months ending before the beginning of the calendar year for which the determination is made (§807).

Tax Cuts & Jobs Act Changes: The Act provides that for purposes of determining the deduction for increases in certain reserves of a life insurance company, the amount of the life insurance reserves for any contract (other than certain variable contracts) is the greater of:

(1) the net surrender value of the contract (if any), *or*

(2) 92.81% of the amount determined using the tax reserve method otherwise applicable to the contract as of the date the reserve is determined.

> **Comments:** Insurance regulators have been changing how life insurance companies must calculate and maintain reserves. The current rules in the Tax Code do not provide how reserves measured in the new matter should be taken into account for tax purposes. The provision would also replace the current-law prescribed reserve rules with rules taking into account reserves on an economically neutral basis. The current-law rule that uses a regulatory-based measurement generally understates income.

Effective date: The changes generally are effective for tax years beginning after 2017. The effect of the provision on computing reserves for contracts issued before the effective date is taken into account ratably over the succeeding eight tax years.

Adjustment For Change In Computing Reserves Changed

Prior or Existing Law: Taxpayers are required to make adjustments to taxable income when they change a tax accounting method so that the accounting method change does not result in an omission or duplication of income or expense. For taxpayers other than life insurance companies, an adjustment that reduces taxable income generally is taken into account in the tax year during which the accounting method change occurs, while an adjustment that increases taxable income generally may be taken into account over the course of four tax years, beginning with the tax year during which the accounting method change occurs (§807). For life insurance companies, an adjustment in computing reserves (which is similar to a change in tax accounting method for other businesses) may be taken into account over ten years (regardless of whether the adjustment reduces or increases taxable income).

Tax Cuts & Jobs Act Changes: The special 10-year period for adjustments to take into account changes in computing reserves by life insurance companies is repealed. As a result, the general rule for making tax accounting method adjustments would apply to changes in computing reserves by life insurance companies. Income or loss resulting from a change in method of computing life insurance company reserves is taken into account consistent with IRS procedures, generally ratably over a four-year period, instead of over a 10-year period.

Effective date: The change is effective for tax years beginning after 2017.

Proration of Dividends Received Deduction Modified

Prior or Existing Law: For insurance companies, deductions are limited or disallowed in certain circumstances if they are related to the receipt of exempt income. Under so-called "proration" rules, life insurance companies are required to reduce deductions, including dividends-received deductions and reserve deductions, to account for the fact that a portion of dividends and tax-exempt interest received is used to fund tax-deductible reserves for the companies' obligations to policyholders. This portion is determined by a formula that computes the respective shares of net investment income that belong to the company and to the policyholders (§812). Current law is unclear as to what methods companies may use to compute the company share.

Tax Cuts & Jobs Act Changes: The Act modifies the life insurance company proration rule for reducing dividends received deductions and reserve deductions with respect to untaxed income. For purposes of the life insurance proration rule of §805(a)(4), the company's share is 70%. The policyholder's share is 30%.

> **Comments:** The current-law rules for computing net investment income are very complex and essentially based on a previous system of life insurance company taxation that was changed over 30 years ago. The provision would set the industry average of the company share as the company share for tax purposes.

Effective date: The change is effective for tax years beginning after 2017.

Special Distribution Rule for Pre-1984 Accounts Repealed

Prior or Existing Law: Tax rules for insurance companies that were enacted in 1959 included a rule that half of a life insurer's operating income was taxed only when the company distributed it, and a "policyholders surplus account" kept track of the untaxed income. In 1984, this deferral of taxable income was repealed, although existing policyholders' surplus account balances remained untaxed until they were distributed. Legislation enacted in 2004 provided a two-year holiday that permitted tax-free distributions of these balances during 2005 and 2006. During this period, most companies eliminated or significantly reduced their balances (§815).

Tax Cuts & Jobs Act Changes: The rules for policyholders' surplus accounts are repealed.

Effective date: The change is effective for tax years beginning after 2017.

Proration For Property & Casualty Companies Modified

Prior or Existing Law: Deductions are limited or disallowed in certain circumstances if they are related to the receipt of exempt income. Under so-called "proration" rules that reflect the fact that reserves generally are funded in part by certain untaxed income, property and casualty (P&C) insurance companies are required to reduce reserve deductions for losses incurred by 15% of:

(1) the company's tax-exempt interest,

(2) the deductible portion of dividends received, *and*

(3) the increase for the tax year in the cash value of life insurance, endowment, or annuity contracts the company owns (§832)

Tax Cuts & Jobs Act Changes: The 15% reduction in the reserve deduction for P&C insurance companies is increased to 25%.

> **Comment:** The provision would keep the reduction in the reserve deduction consistent with current law by adjusting the rate proportionately to the decrease in the corporate tax rate.

Effective date: The change is effective for tax years beginning after 2017.

Discounting For Property & Casualty Companies Modified

Prior or Existing Law: A P&C insurance company may deduct unpaid losses that are discounted using mid-term applicable Federal rates and based on a loss payment pattern. The loss payment pattern for each line of insurance business is determined by reference to the industry-wide historical loss payment pattern applicable to such line of business, although companies may elect to use their own particular historical loss payment patterns (§832).

The loss payment pattern is computed based upon the assumption that all losses are paid:

(1) in general, during the accident year and the three calendar years following the accident year, *or*

(2) in the case of lines of business relating to auto or other liability, medical malpractice, workers' compensation, multiple peril lines, international coverage, and reinsurance, during the accident year and the ten calendar years following the accident year.

In the case of long-tail lines of business, a special rule extends the loss payment pattern period, so that the amount of losses which would have been treated as paid in the tenth year after the accident year is treated as paid in the tenth year and in each subsequent year (up to five years) in an amount equal to the amount of the losses treated as paid in the ninth year after the accident year.

Tax Cuts & Jobs Act Changes: P&C insurance companies will use the corporate bond yield curve (as specified by Treasury) to discount the amount of unpaid losses. In addition, the special rule that extends the loss payment pattern period for long-tail lines of business would be applied similarly to all lines of business (but with the 5-year limitation on the extended period increased to 14 years).

The Act also repeals the election to use company-specific, rather than industry-wide, historical loss payment patterns.

> **Comments:** Replacing the mid-term applicable Federal rate with the corporate bond yield would result in a more accurate measurement of income for P&C insurance companies. In addition, generally applying the rules for determining the loss payment pattern period that currently only apply to long-tail lines of business would provide consistent treatment for all lines of insurance business.

Effective date: The change is effective for tax years beginning after 2017, with a transition rule that spreads adjustments relating to pre-effective date losses and expenses over such tax year and the succeeding seven tax years.

Special Estimated Tax Payments Repealed

Prior or Existing Law: Insurance companies may elect to claim a deduction equal to the difference between the amount of reserves computed on a discounted basis and the amount computed on an undiscounted basis. Companies that make this election are required to make a special estimated tax payment equal to the tax benefit attributable to the deduction. In addition, the deductions are added to a special loss discount account and, as losses are paid in future years, amounts are subtracted from the account and made subject to tax (net of prior special estimated tax payments). Amounts added to the special loss discount account are automatically subtracted from the account and made subject to tax if they have not already been subtracted after 15 years (§847).

Tax Cuts & Jobs Act Changes: The elective deduction and related special estimated tax payment rules are repealed.

Effective date: The change is effective for tax years beginning after 2017.

Capitalization Of Certain Policy Acquisition Expenses Modified

Prior or Existing Law: The expenses of a life insurance company that are associated with earning a stream of premium income generally are required to be spread over ten years rather than deducted immediately, to reflect the fact that such income ordinarily is collected over a period of years (§848). The expenses that are spread are calculated using a simplified method that reflects expense ratios for three broad categories of insurance contracts. The expenses that must be spread are the lesser of:

(1) a specified percentage of the net premiums received on each of a company's three categories of insurance contracts; *or*

(2) the company's general deductions.

For annuity contracts, the specified percentage is 1.75%; for group life insurance contracts, it is 2.05%; and for all other specified insurance contracts, it is 7.7%.

Tax Cuts & Jobs Act Changes: The amortization period is 180 months. For annuity contracts, the percentage is 2.09%; for group life insurance contracts, the percentage is 2.45%; and for all other specified insurance contracts, the percentage is 9.20%.

Effective date: The changes are effective for tax years beginning after 2017.

Tax Reporting For Life Settlement Transactions New Reporting

Prior or Existing Law: Under rules known as the transfer for value rules, if a life insurance contract is sold or otherwise transferred for valuable consideration, the amount paid by reason of the death of the insured that is excludable generally is limited (§101). Under the limitation, the excludable amount may not exceed the sum of:

(1) the actual value of the consideration, *and*

(2) the premiums or other amounts subsequently paid by the transferee of the contract.

Tax Cuts & Jobs Act Changes: The Act imposes reporting requirements in the case of the purchase of an existing life insurance contract in a reportable policy sale and imposes reporting requirements on the payor in the case of the payment of reportable death benefits. The provision sets forth rules for determining the basis of a life insurance or annuity contract.

Compensation

Lastly, the provision modifies the transfer for value rules in a transfer of an interest in a life insurance contract in a reportable policy sale.

Effective date: The changes are generally effective for tax years beginning after 2017. The clarification of the basis rules for life insurance and annuity contracts is effective for transactions entered into after August 25, 2009.

Excessive Employee Remuneration Limitation Modified

Prior or Existing Law: A corporation generally may deduct compensation expenses as an ordinary and necessary business expense. The deduction for compensation paid or accrued with respect to a covered employee of a publicly traded corporation, however, is limited to no more than $1 million per year (§162). The deduction limitation applies to all remuneration paid to a covered employee for services, including cash and the cash value of all remuneration (including benefits) paid in a medium other than cash, subject to several significant exceptions:

- **(1)** commissions;
- **(2)** performance-based remuneration, including stock options;
- **(3)** payments to a tax-qualified retirement plan; *and*
- **(4)** amounts that are excludable from the executive's gross income.

A covered employee is the chief executive officer (CEO) and the next four highest compensated officers based on the Securities and Exchange Commission (SEC) disclosure rules. Due to changes in the applicable SEC disclosure rules, IRS guidance has interpreted "covered employee" to mean the principal executive officer and the three highest compensated officers as of the close of the tax year.

Tax Cuts & Jobs Act Changes: The exceptions to the $1 million deduction limitation for commissions and performance-based compensation are repealed. The provision also revises the definition of "covered employee" to include the CEO, the chief financial officer, and the three other highest paid employees, realigning the definition with current SEC disclosure rules. Under the modified definition, once an employee qualifies as a covered person, the deduction limitation applies for Federal tax purposes to that person so long as the corporation pays remuneration to such person (or to any beneficiaries).

> **Comments:** The significant exceptions to the current limit on the deductible executive compensation by publicly traded corporations have resulted in a shift away from cash compensation paid to senior executives in favor of stock options and other forms of per-

formance pay. This shift has led to perverse consequences as some executives focus on - and could, in rare cases, manipulate - quarterly results (off of which their compensation is determined), rather than on the long-term success of the company.

Effective date: The change is effective for tax years beginning after 2017. A transition rule applies to remuneration which is provided pursuant to a written binding contract which was in effect on November 2, 2017, and which was not modified in any material respect on or after such date.

Tax-Exempt Organization Executive Compensation Tax

Prior or Existing Law: The deduction allowed to publicly traded C corporations for compensation paid with respect to chief executive officers and certain highly paid officers is limited to no more than $1 million per year. Similarly, current law limits the deductibility of certain severance-pay arrangements ("parachute payments"). No parallel limitation applies to tax-exempt organizations with respect to executive compensation and severance payments.

Tax Cuts & Jobs Act Changes: An employer is liable for an excise tax equal to 21% of the sum of:

(1) any remuneration (other than an excess parachute payment) in excess of $1 million paid to a covered employee (i.e., any of its five highest-paid employees) by an applicable tax-exempt organization (i.e., exempt from tax under §501(a)) for a taxable year, *and*

Note: Remuneration is treated as paid when there is no substantial risk of forfeiture (see §457) of the rights to such remuneration. However, remuneration of a covered employee that is not deductible by reason of the $1 million limit on deductible compensation is not taken into account.

(2) any excess parachute payment (under a new definition for this purpose that relates solely to separation pay) paid by the applicable tax-exempt organization to a covered employee.

Accordingly, the excise tax applies as a result of an excess parachute payment, even if the covered employee's remuneration does not exceed $1 million. However, compensation paid to employees who are not highly compensated employees (within the meaning of section 414(q)) and compensation attributable to medical services of certain qualified medical professionals (e.g., doctor, nurse, or veterinarian) are exempt from the definition of parachute payment.

Comments: Current law generally has no limit on excessive compensation paid by a tax-exempt organization to its senior management other than the limitation on private inurement, the consequence of which can be revocation of the organization's exemption. Tax-exempt organizations enjoy a tax subsidy from the Federal government as a result of the requirement that they use their resources for specific purposes. Some may question whether excessive executive compensation diverts resources from those particular purposes. The provision is consistent with the limitation on the deductibility of executive compensation by taxable publicly traded corporations. Given that exemption from Federal income tax constitutes a significant benefit conferred upon tax-exempt organizations, the case for discouraging excess compensation paid out to such organizations' executives may be even stronger than it is for publicly traded companies.

Effective date: The change is effective for tax years beginning after 2017.

Qualified Equity Grants Taxation

Prior or Existing Law: Employers may grant various forms of stock compensation to employees, including non-statutory and statutory stock options, restricted stock, restricted stock units, and stock appreciation rights. The tax treatment of these various forms of stock compensation depends on the specific terms and conditions of the arrangement and applicable rules

In the case of an *employer's transfer of stock* to an employee, specific rules govern the amount and timing of the income employee's inclusion and the employer's compensation deduction (§§83, 3401 & 6051). An employee generally must recognize income (equal to the fair market value of the stock as of the date of transfer) in the taxable year in which the employee's right to the stock is transferable or is not subject to a substantial risk of forfeiture. The employer is allowed a deduction equal to the amount included in the employee's income.

> **Note:** If the employee's right to the stock is non-vested at the time the stock is transferred to the employee, the employee may make a §83(b) election within 30 days of transfer to currently recognize the income in the transfer year.

The above rules, apply to *nonqualified stock options* when the employee exercises the option. However, no amounts are includible in an employee's income on the grant, vesting, or exercise of a *statutory option* (§§421-424). Likewise, no deduction is allowed to the employer with respect to the option or the stock transferred to an employee. If a holding requirement (2 years from grant, 1 year from exercise) is met and the employee later sells the stock, the gain can be capital gain rather than ordinary income.

There are two types of *statutory employer stock options*:

(1) incentive stock options (ISOs), *and*

(2) those provided under an employee stock purchase plan (ESPP).

In the case of a *nonqualified deferred compensation*, unless the arrangement either is exempt from or meets the requirements of §409A, the amount of deferred compensation is first includible in income for the taxable year when not subject to a substantial risk of forfeiture, even if payment will not occur until a later year. The employer deduction is permitted when the amount is included in the employee's income.

Tax Cuts & Jobs Act Changes: The Act allows a qualified employee to make a deferral election similar to the 30 day §83(b) election for employer qualified stock transferred to an employee (or with restrictions, qualified stock attributable to a statutory option). Both "qualified employee" and "qualified stock" are specifically defined.

If a qualified employee uses this new election to defer income, the income must later be included on the earliest of:

(1) the first date the qualified stock becomes transferable;

(2) the date the employee first becomes an excluded employee;

Note: An excluded employee is any individual who (1) was a 1% owner during the preceding 10 years, (2) is or has been, the CEO or CFO of the corporation, (3) is a family member of an individual described in (1) or (2), or (4) has been one of the four highest compensated officers during the 10 preceding years.

(3) the first date on which the stock becomes readily tradable on an established securities market;

(4) the date five years after the first date the employee's right to the stock becomes substantially vested; *or*

(5) the date on which the employee revokes her inclusion deferral election.

A corporation transferring qualified stock to a qualified employee must provide a notice at the time (or a reasonable period before) of the employee's vesting in the qualified stock and that income attributable to the stock would be includible absent an inclusion deferral election.

Effective date: The changes are effective for tax years beginning after 2017.

Excise Tax On Expatriated Corporate Stock Compensation

Prior or Existing Law: Under §4985, certain holders of stock options and other stock-based compensation are subject to an excise tax upon certain transactions that result in an expatriated corporation (also referred to as corporate inversions). The section imposes an excise tax, currently at the rate of 15%, on the value of specified stock compensation held (directly or indirectly) by or for the benefit of a disqualified individual, or a member of such individual's family, at any time during the 12-month period beginning six months before the corporation's expatriation date.

Selected International Provisions

Tax Cuts & Jobs Act Changes: The 15% rate of excise tax, imposed on the value of stock compensation held by insiders of an expatriated corporation, is increased to 20%.

Effective date: The change applies to corporations first becoming expatriated corporations after the date of enactment.

Foreign-Source Dividends Deduction

Prior or Existing Law: U.S. citizens, resident individuals, and domestic corporations generally are taxed on all income, whether earned in the United States or abroad. Foreign income earned by a foreign subsidiary of a U.S. corporation generally is not subject to U.S. tax until the income is distributed as a dividend to the U.S. corporation. To mitigate the double taxation on earnings of the foreign corporation, the United States allows a credit for foreign income taxes paid. The foreign tax credit generally is available to offset, in whole or in part, the U.S. tax owed on foreign income. When foreign tax credits are insufficient to offset the U.S. tax liability on the foreign subsidiary's earnings, the additional U.S. tax the U.S. corporation must pay upon receiving those earnings is referred to as the "U.S. residual tax." A U.S. taxpayer may elect to deduct foreign income taxes paid rather than claim the credit.

Tax Cuts & Jobs Act Changes: The Act allows an exemption for certain foreign income by means of a 100% deduction for the foreign-source portion of dividends received from specified 10% owned foreign corporations by domestic corporations that are United States shareholders of those foreign corporations within the meaning of §951(b). This deduction is available only for the foreign-source portion of dividends received by a domestic corporation from specified 10-percent owned foreign corporations. The foreign-source portion of any dividend is the amount that bears the same ratio to the dividend as the undistributed foreign earnings bears to the total undistributed earnings of the foreign corporation. However, no foreign tax credit or deduction is allowed for any taxes paid or accrued with respect to any portion of a distribution treated as a dividend that qualifies for the deduction.

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

The deduction is not available for a hybrid dividend received by a U.S. shareholder. A hybrid dividend is an amount received from a controlled foreign corporation for which the specified 10%-owned foreign corporation received a deduction (or other tax benefit) from any income, war profits, and excess profits taxes imposed by a foreign country.

> **Comments:** The provision would allow U.S. companies to compete on a more level playing field against foreign multinationals when selling products and services abroad by eliminating an additional level of tax that their competitors do not face. The provision would eliminate the "lock-out" effect which encourages U.S. companies to avoid bringing their foreign earnings back into the United States so that they can avoid the U.S. residual tax on those earnings.

Effective date: The change is effective for distributions made after 2017.

Transfers with Specified 10% Owned Foreign Corporations

Prior or Existing Law: Any gain that is recognized by a U.S. parent corporation on the sale or exchange of its stock in a foreign subsidiary generally is treated as a dividend distribution by the foreign subsidiary to its U.S. parent to the extent of earnings and profits (E&P) that have been accumulated by the foreign subsidiary while it had been owned by the U.S. parent. Any gain in excess of that typically is capital gain to the U.S. parent.

In some cases, U.S. companies may operate businesses in foreign countries through a branch rather than through a separate, foreign subsidiary. In these situations, U.S. companies pay U.S. taxes on the foreign earnings or deduct losses on a current basis, as if earned directly by the U.S. parent.

Tax Cuts & Jobs Act Changes: A U.S. parent would reduce the basis of its stock in a foreign subsidiary by the amount of any exempt dividends received by the U.S. parent from its foreign subsidiary - but only for purposes of determining the amount of a loss (but not the amount of any gain) on any sale or exchange of the foreign subsidiary stock by its U.S. parent.

In addition, if a U.S. corporation transfers substantially all of the assets of a foreign branch to a foreign subsidiary, the U.S. corporation would be required to include in income the amount of any post-2017 losses that were incurred by the branch.

Effective date: The change is effective for transfers after 2017.

Deemed Repatriation of Deferred Foreign Income

Prior or Existing Law: A U.S. corporate shareholder of a foreign subsidiary generally is not subject to U.S. tax on the earnings of the foreign subsidiary until the earnings are distributed to the U.S. parent corporation (i.e., deferred foreign income taxation). The foreign subsidiary's undistributed earnings that are reinvested in United States property are subject to current U.S. tax. For this purpose, United States property generally includes tangible property located in the United States, intangible property used in the United States, and equity and debt interests in U.S. affiliates. As a result, a U.S. corporate shareholder cannot avoid U.S. tax on the distribution of earnings from a foreign subsidiary by instead reinvesting those earnings in United States property.

Tax Cuts & Jobs Act Changes: The Act generally requires that, for the last taxable year beginning before January 1, 2018, any U.S. shareholder of a specified foreign corporation (i.e., any foreign corporation in which a U.S. person owns a 10% voting interest) must include in income its pro rata share of the accumulated post-1986 deferred foreign income of the corporation.

A portion of the pro rata share of foreign earnings is deductible depending on whether the deferred earnings are held in cash or other assets. The result is a reduced rate of tax with respect to income from the required inclusion of pre-effective date earnings. The reduced rate of tax is 15.5% for cash and cash equivalents and 8% for all other earnings.

> **Note:** The corresponding portion of the credit for foreign taxes is disallowed, thus limiting the credit to the taxable portion of the included income. However, the foreign tax credit limitation rules of §904 still apply rules.

The increased tax liability generally may be paid over an eight-year period. Special rules are provided for S corporations and real estate investment trusts.

> **Comments:** The provision would remove disincentives for the investment of foreign earnings in the United States. Under §4001 of the Act, a 100% exemption would be provided for the foreign-source portion of dividends from the foreign subsidiary of a U.S. corporate shareholder. As a result, no U.S. tax would be avoided by a U.S. parent corporation reinvesting earnings of its foreign subsidiary in United States property rather than distributing those earnings.

Effective date: The change is effective for the last taxable year of a foreign corporation that begins before January 1, 2018, and with respect to U.S. shareholders, for the taxable years in which or with which such taxable years of the foreign corporations end.

Domestic Taxable Income Offset Election

Prior or Existing Law: A taxpayer realizing overall foreign source loss must recharacterize foreign source income earned in later years as U.S. source income to the extent of prior foreign losses (§904). Before offsetting U.S. income, foreign losses in one separate foreign tax credit limitation category must be offset against income in other foreign categories. However, U.S. source income may be resourced as foreign source income if a taxpayer's foreign tax credit limitation is reduced due to an overall domestic loss sustained.

Tax Cuts & Jobs Act Changes: The provision modifies §904(g) by providing an election to increase the percentage (but not greater than 100%) of domestic taxable income offset by any pre-2018 unused overall domestic loss and recharacterized as foreign source. The term "pre-2018 unused overall domestic loss" means any overall domestic loss which:

- **(1)** arises in a qualified taxable year beginning before January 1, 2018, *and*
- **(2)** has not been used under the general rule set forth in §904(g)(1).

The term "qualified taxable year" means any taxable year of the taxpayer beginning after December 31, 2017, and before January 1, 2028.

Effective date: The change applies to taxable years beginning after 2017.

Foreign-Derived Intangible Income Deduction

Prior or Existing Law: None.

Tax Cuts & Jobs Act Changes: The Act allows a US corporation a new deduction in respect of its "foreign-derived intangible income" (FDII) and "global intangible low-taxed income" (GILTI) inclusion (§250). After 2017 and before 2025, the deduction generally is equal to the sum of:

- **(1)** 37.5% of the US corporation's FDII, *and*
- **(2)** 50% of the sum of:
  - **(a)** its GILTI inclusion, *and*
  - **(b)** corresponding §78 dividends.

After 2025, the above percentages are reduced to 21.875% and 37.5%, respectively.

Deduction eligible income is the excess (if any) of the gross income of the corporation (determined without regard to certain exceptions to deduction eligible income) over deductions (including taxes) properly allocable to such gross income (referred to in this document as "deduction eligible gross income")

> **Note:** Under a 21% corporate tax rate, and as a result of the deduction for FDII and GILTI, the effective tax rate on FDII is 13.125% and the effective U.S. tax rate on GILTI

(with respect to domestic corporations) is 10.5% for taxable years beginning after 2017, and before 2026.

Effective date: The change applies to taxable years beginning after 2017.

Indirect Foreign Tax Credits Repealed

Prior or Existing Law: Under §902, a foreign tax credit is allowed to a domestic corporation that owns at least 10% of a foreign corporation from which it receives a dividend. The credit is calculated based on the portion of the foreign corporation's post-1986 foreign income taxes that the dividend received by the foreign corporation bears to the foreign corporation's post-1986 undistributed earnings. The credit is often called the "deemed-paid" or "indirect" credit.

Tax Cuts & Jobs Act Changes: The §902 deemed-paid foreign tax credit is repealed.

> **Note:** The §960 deemed-paid foreign tax credit for subpart F inclusions is retained, but modified to a current year basis, without regard to pools of foreign earnings kept abroad.

Effective date: The change applies to taxable years beginning after 2017.

Source Of Income From Sales Of Inventory Modified

Prior or Existing Law: In determining the source of income for foreign tax credit purposes, up to 50% of the income from the sale of inventory property that is produced within the United States and sold outside the United States (or vice versa) may be treated as foreign-source income, even though the production activity takes place entirely within the United States.

Tax Cuts & Jobs Act Changes: Income from the sale of inventory property produced within and sold outside the United States (or vice versa) is allocated and apportioned between sources within and outside the United States solely on the basis of the production activities with respect to the inventory.

Effective date: The change applies to taxable years beginning after 2017.

Passive Foreign Investment Insurance Exception

Prior or Existing Law: U.S. shareholders of a passive foreign investment company (PFIC) are taxed currently on the PFIC's earnings. A PFIC is defined as any foreign corporation:

- **(1)** 75% or more of the gross income of which is passive, or
- **(2)** at least 50% of the assets of which produce passive income.

Among other exceptions, passive income does not include any income that is derived in the active conduct of an insurance business if the PFIC is predominantly engaged in an insurance business and would be taxed as an insurance company were it a U.S. corporation.

Tax Cuts & Jobs Act Changes: The PFIC exception for insurance companies is amended to apply only if the foreign corporation would be taxed as an insurance company were it a U.S. corporation and if loss and loss adjustment expenses, unearned premiums, and certain reserves constitute more than 25% of the foreign corporation's total assets (or 10% if the corporation is predominantly engaged in an insurance business and the reason for the percentage falling below 25 is solely due to temporary circumstances).

Effective date: The change is effective for tax years beginning after 2017.

Fair Market Value Of Interest Expense Apportionment

Prior or Existing Law: Subject to certain limitations, U.S. citizens, resident individuals, and domestic corporations are allowed to claim credit for foreign income taxes they pay. The foreign tax credit generally is limited to a taxpayer's U.S. tax liability on its foreign source taxable income. The computation of the foreign tax credit limitation requires a taxpayer to determine the amount of its taxable income from foreign sources by allocating and apportioning deductions between U.S.-source gross income, on the one hand, and foreign-source gross income in each limitation category, on the other.

Tax Cuts & Jobs Act Changes: The Act prohibits members of a U.S. affiliated group from allocating interest expense on the basis of the fair market value of assets for purposes of §864(e). Instead, the members must allocate interest expense based on the adjusted tax basis of assets.

Effective date: The change is effective for taxable years beginning after 2017.

Foreign Person Sale of U.S. Partnership Interest

Prior or Existing Law: Gain or loss from the sale or exchange of a partnership interest generally is treated as gain or loss from the sale or exchange of a capital asset (§741). However, the amount of money and the fair market value of property received in the exchange that represent the partner's share of certain ordinary income-producing assets of the partnership give rise to ordinary income rather than capital gain (§751).

A foreign person that is engaged in a trade or business in the United States is taxed on income that is "effectively connected" with the conduct of that trade or business ("effectively connected gain or loss"). Partners in a partnership are treated as engaged in the conduct of a trade or business within the United States if the partnership is so engaged.

Tax Cuts & Jobs Act Changes: Gain or loss from the sale or exchange of a partnership interest is effectively connected with a U.S. trade or business to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange. Any gain or loss from the hypothetical asset sale by the partnership is allocated to interests in the partnership in the same manner as nonseparately stated income and loss. The transferee of a partnership interest must withhold 10% of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that the transferor is not a nonresident alien individual or foreign corporation.

Exempt Organizations

Effective date: The portion of the provision treating gain or loss on sale of a partnership interest as effectively connected income is effective for sales, exchanges, and dispositions on or after November 27, 2017. The portion of the provision requiring withholding on sales or exchanges of partnership interests is effective for sales, exchanges, and dispositions after 2017.

Tax-exempt entities such as charities, foundations, and other non-profit organizations provide needed assistance and support to millions of families and communities nationwide. Some Tax Code provisions for tax-exempt entities are out of date and require updating to truly reflect the necessities of tax-exempt entities in today's environment.

The net investment excise tax on private foundations has long been a source of confusion and frustration for taxpayers. Private foundations, both large and small, recommended to the Committee's Tax Reform Working Group on Charitable/Exempt Organizations that the net investment tax be reduced to a lower rate in order to ease compliance. The bill adopts this recommendation to ease the administrative burden on foundations and encourage more funding of charitable activities.

Endowments at many private colleges are large enough that parity requires that they be placed on equal footing with private foundations when it comes to paying a tax on net investment income.

Unrelated Business Income Tax ("UBIT")

UBIT Separately Computed

Prior or Existing Law: Section 501(a) exempts certain organizations from Federal income tax. However, the Federal income tax exemption does not extend to an organization's unrelated trade or business income. The unrelated business income tax ("UBIT") generally applies to income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.

Under §512(b)(12), an exempt organization may take a specific deduction of $1,000 in computing unrelated business taxable income. This specific deduction may not be used to create a net operating loss that will be carried back or forward to another year.

Tax Cuts & Jobs Act Changes: For an organization with more than one unrelated trade or business, the Act requires that unrelated business taxable income first be computed separately with respect to each trade or business and without regard to the specific deduction generally allowed under §512(b)(12). The organization's unrelated business taxable income for a taxable year is the sum of the amounts (not less than zero) computed for each separate unrelated trade or business, less the specific deduction allowed under §512(b)(12). A net operating loss deduction is allowed only with respect to a trade or business from which the loss arose.

> **Note:** The result of the provision is that a deduction from one trade or business for a taxable year may not be used to offset income from a different unrelated trade or business for the same taxable year. The provision generally does not, however, prevent an organization from using a deduction from one taxable year to offset income from the same unrelated trade or business activity in another taxable year, where appropriate.

Effective date: The change is effective for tax years beginning after 2017.

Excise Taxes

Private College And University Investment Income

Prior or Existing Law: Private foundations and certain charitable trusts are subject to an excise tax of up to 2% on their net investment income (the Act would reduce this excise tax to 1.4%). The excise tax on net investment income does not apply to public charities, including colleges and universities, even though some such organizations may have substantial investment income similar to private foundations.

Tax Cuts & Jobs Act Changes: Certain private colleges and universities are subject to a 1.4% excise tax on net investment income. The provision only applies to private colleges and universities that have more than 50% of the tuition-paying students of which are located in the United States (§4968). State colleges and universities are not subject to the provision.

Effective date: The change is effective for tax years beginning after 2017.

Section 4 – Review Questions

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

15. For years, State and local governments have used tax credit bonds to fund specific types of Federally subsidized projects. Holders of such bonds receive Federal tax credits in lieu of interest (§54). The TCJA affects the use of these bonds by:

    a. renewing those that have expired.

    b. repealing them.

    c. giving holders the option of direct payments from the Federal government.

    d. increase the issuing volume cap for such bonds.

16. While most businesses can carry back net operating losses for two years or forward for 20 years, under a special rule, life insurance companies can carry them back for three years or forward for 15 years. The TCJA changes this special treatment by:

    a. permitting life insurance companies a 5 year carry back.

    b. disallowing net operating losses of life insurance companies

    c. permitting life insurance companies a 25 year carry forward.

    d. applying general net operating loss carryover rules to insurance companies.

17. Insurance companies can elect to take a deduction equal to the difference between discounted and undiscounted reserves. Those that so elect must make a special estimated tax payment equal to the attributable tax benefit. The TCJA changes this special estimated tax payment by:

    a. repealing it.

    b. doubling the amount of the special estimated payment.

    c. changing the time period for making the election

    d. expanding the special election to all businesses.

18. While the annual deduction allowed to publicly traded C corporations for compensation paid with respect to certain highly paid officers is limited to $1 million, no parallel limitation applies to tax-exempt organizations. How did the TCJA, change this rule?

    a. It permanently exempted such organizations from any excise tax.

    b. It characterized any compensation in excess of $1 million to key employees as unrelated business taxable income.

    c. It revoked the tax-exempt status of any organization paying compensation in excess of $1 million to key employees.

    d. An executive excise compensation tax was applied to exempt organizations.

19. A foreign tax credit is allowed to a domestic corporation that owns at least 10% of a foreign corporation from which it receives a dividend (§902). This credit (often called the "deemed-paid" credit) has been much criticized and the TCJA:

    a. repeals the deemed paid foreign tax credit under §902

    b. changed the ownership percentage to 20%

    c. converted a credit to a deduction.

    d. placed the limit on the credit of $500,000.

20. While certain organizations are exempt from Federal income tax (§501(a)), the exemption does not extend to an organization's unrelated trade or business income. However, an exempt organization may take a deduction of $1000 in calculating unrelated business taxable income (UBTI). The TCJA clarifies the application of this deduction by:

    a. aggregating UBTI for all businesses before subtracting the deduction.

    b. allowing the deduction for the UBTI of each separate business.

    c. repealing the deduction.

    d. preventing the deduction to be used across multiple tax years.

Review Question Answers and Rationales

Review question answer choices are accompanied by unique, logical reasoning (rationales) as to why an answer is correct or incorrect. Evaluative feedback to incorrect responses and reinforcement feedback to correct responses are both provided.

Section 1

1. In 2020, Mary earned $40,000. What is Mary's marginal income tax rate if she files as head of household?

   a. Correct. The 2020 taxable income rate for a taxpayer who earns between $14,100 and $53,700 and is filing as head of household is 12%. Head of household is disproportionately favored under the Code and should not be overlooked.

   b. Incorrect. The 2020 taxable income rate for a taxpayer who earns *between $53,700 and $85,500* and is filing as head of household is 22%. Still, 22% is a very favorable rate for this amount of income.

   c. Incorrect. The 2020 taxable income rate for a taxpayer who earns *between $85,500 and $163,300* and is filing as head of household is 24%. Not too long ago 28% was the capital gain rate.

   d. Incorrect. The 2020 taxable income rate for a taxpayer who earns between $163,300 and $207,350 and is filing as head of household is 32%. Even at 32%, this is the marginal rate, not the effective rate. [p. 2]

2. A taxpayer's filing requirement, standard deduction, and tax rate are determined by his or her filing status. What is the filing status of an unmarried taxpayer?

   a. Incorrect. Under the Code, there is no such tax filing status as individual. However, married individuals may file as married filing separately.

   b. Correct. When a taxpayer is unmarried, their filing status is single or head of household. Practitioners should exercise care in using the single tax filing status. In many cases, the taxpayer could also qualify for head of household which is disproportionately favored under the Code.

   c. Incorrect. While some states have recognized a tax status as domestic partner (e.g., California), the federal government has not. However, same-sex marriage is legal nationwide (excluding American Samoa and some Native American tribal jurisdictions) and is recognized by the federal government.

   d. Incorrect. Living together is not a tax filing status under the Code. [p. 5]

3. Parents can take advantage of numerous child-related credits. Which credit is available to certain taxpayers based on having a qualifying child under age 17?

a. Incorrect. The lifetime learning credit was a credit for higher education expenses and was not based on having a qualified child under age 17.

b. Correct. The child tax credit, under §24, is a credit provided based on having a qualified child under age 17. A qualified child is determined under the uniform qualified child definition.

c. Incorrect. The Hope credit was for higher educational expenses and was not based on having a qualified child under age 17.

d. Incorrect. The adoption credit is a credit for qualified adoption expenses paid or incurred by a taxpayer and is not based on having a qualified child under age 17. [p. 8]

4. An education savings account (ESA) is a trust or custodial account established to pay for a named beneficiary's qualified education expenses. Under §530, why should someone contribute to a Coverdell ESA?

a. Incorrect. If for a year, withdrawals from an account are not more than a designated beneficiary's qualified education expenses at an eligible educational institution, the beneficiary will not owe tax on the withdrawals.

b. Incorrect. Contributions to a Coverdell ESA are not deductible.

c. Correct. Under §530, a reason to contribute to a Coverdell ESA is that earnings on the account grow tax-free until withdrawn.

d. Incorrect. For Coverdell ESAs, the contribution limit is $2,000 per beneficiary. [p. 10]

5. A charitable contribution deduction is limited to a certain percentage of the individual's adjusted gross income (AGI). If an individual contributes more than the applicable AGI limits:

a. Correct. If an individual contributes more than the applicable AGI limits, the excess contribution generally may be carried over and deducted in the following five tax years, or 15 years in the case of qualified conservation contributions.

b. Incorrect. The excess is not disallowed but, can be carried forward.

c. Incorrect. A deduction is allowed for a contribution of $250 or more only if the taxpayer provides a contemporaneous written acknowledgement by the organization to which the contribution is made, meeting certain informational requirements.

d. Incorrect. The AGI limitation varies depending on the type of property contributed and the type of exempt organization receiving the property. There's no procedure for requesting an increase in the limitation. [p15]

Section 2

6. Which of the following is included as a miscellaneous itemized deduction under §67?

a. Incorrect. Miscellaneous itemized deductions do *not* include business travel airfares for purposes of §67.

b. Incorrect. Miscellaneous itemized deductions do *not* include impairment-related work expenses for purposes of §67.

c. Incorrect. Miscellaneous itemized deductions do *not* include reimbursed employee business expenses for purposes of §67

d. Correct. Miscellaneous itemized deductions include unreimbursed employee business expenses, including union and professional dues and office-at-home expenses to the extent deductible. [p18]

7. The Tax Cut & Jobs Act of 2017 had an impact on estate planning. As a result of this legislation, what happened to the 2020 federal estate tax exclusion amount?

a. Correct. As a result of the Tax Cut & Jobs Act of 2017, the federal exclusion amount for estate tax purposes became $11.58 million in 2020.

b. Incorrect. In 2004, the estate and gift tax rates in excess of 48% were repealed, and the federal exclusion amount for estate tax purposes increased to $1.5 million.

c. Incorrect. In 2007, the estate and gift tax rates in excess of 45% were repealed, and the federal exclusion amount for estate tax purposes was raised to $2 million.

d. Incorrect. In 2009, the federal estate tax exclusion amount increased to $3.5 million. [p. 23]

8. The Tax Cut And Jobs Act of 2017 (TCJA) made an important change to the Affordable Care Act (ACA). As a result of the TCJA, who of the following is exempt from the responsibility requirement to maintain minimum essential coverage?

a. Incorrect. The TCJA repealed the mandate for all individuals not just those with income less than the Federal poverty level.

b. Correct. The TCJA reduced the individual responsibility payment, enacted as part of the Affordable Care Act, to zero, effectively repealing the mandate or tax for all individuals.

c. Incorrect. The TCJA did not change any responsibility obligations for employers under the ACA.

d. Incorrect. The TCJA did not change any responsibility obligations for businesses under the ACA.[p23]

Section 3

9. Over the years, taxpayers have periodically been allowed to take additional first-year (or bonus) depreciation when certain "qualified property" was placed in service. The Tax Cut And Jobs Act of 2017 (TCJA) modified this additional first-year depreciation by:

a. Incorrect. The 50% allowance was increased to 100% for property placed in service after September 27, 2017, and before January 1, 2023.

b. Incorrect. The TCJA repealed the phase-down of the 50% allowance for property placed in service after 2017.

c. Correct. The additional first-year depreciation deduction was extended through 2026 (through 2027 for longer production period property and certain aircraft).

d. Incorrect. The TCJA removes the requirement that the original use of qualified property commence with the taxpayer. Thus, the change applies to purchases of used as well as new items.[p.25]

10. Subject to a number of limitations, business interest generally is allowed as a deduction in the taxable year in which the interest is paid or accrued. However, the TCJA has modified the deduction of business interest by:

a. Correct. Under the TCJA, the deduction for business interest is limited to the sum of (1) business interest income, (2) 30% of the adjusted taxable income of the taxpayer for the taxable year, and (3) the floor plan financing interest of the taxpayer for the taxable year.

b. Incorrect. The amount of any business interest not allowed as a deduction for any taxable year may only be carried forward for up to five years

c. Incorrect. The TCJA does not apply the interest deduction modification to real property development.

d. Incorrect. The limitation generally applies at the taxpayer level. However, in the case of any partnership, the limitation is applied at the partnership level.[p34]

11. Section 1031 provides that no gain or loss shall be recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of a like-kind to be held for similar purposes. The TCJA modifies §1031 to disallow the exchange of:

a. Incorrect. As a result of the TCJA, only exchanges of real property now qualify under §1031. This would be an allowed exchange.

b. Incorrect. Improved real estate for unimproved real estate would an allowed exchange since it constitutes real estate for real estate.

c. Correct. Exchanges of personal property are now disallowed. Section 1031 was modified to only allow for like-kind exchanges with respect to real property.

d. Incorrect. Raw land for an apartment house would be an allowed exchange since it constitutes real estate for real estate.[p35]

12. A technical partnership termination can be painful. The partnership is treated as newly formed and must make new elections for various accounting methods, depreciation lives, and other purposes. The TCJA now helps avoid a technical termination by:

a. Correct. The TCJA repeals the technical termination rule of §704(b).

b. Incorrect. The time period for determining the technical termination has not been increased. It was 12 months but, now the entire provision is repealed.

c. Incorrect. The original technical termination provision applied to the sale or exchange of partnership capital interests. However, now the entire provision is repealed.

d. Incorrect. The original technical termination provision also applied to the sale or exchange of partnership profit interests. However, now the entire provision is repealed.[p40]

13. A partner's distributive share of partnership loss is allowed only to the extent of the adjusted basis of the partner's interest. The TCJA modified the calculation of a partner's basis by:

a. Correct. The TCJA modified the basis limitation on partner losses to provide that the limitation takes into account a partner's distributive share of partnership charitable contributions. The amount of the basis limitation on partner losses is decreased to reflect this item.

b. Incorrect. The TCJA modified the basis limitation on partner losses to provide that the limitation takes into account a partner's distributive share of partnership taxes paid to foreign countries.

c. Incorrect. A partner's basis is increased by their share of taxable partnership income. The TCJA did not change this.

d. Incorrect. Money distributed to the partner increases their basis. The TCJA did not change this.[p.42]

14. Taxpayers can apply the §47 tax credit to costs incurred for certain rehabilitation efforts on old and/or historic buildings. The TCJA now repeals the 10% credit for pre-1936 buildings. However, which of the following activities has always been outside the scope of this credit?

a. Correct. Section 47 rehabilitation does not include enlargement or new construction.

b. Incorrect. Under §47, rehabilitation includes reconstruction.

c. Incorrect. Section 47, rehabilitation includes renovation.

d. Incorrect. Under §47, rehabilitation includes restoration. [p.45]

Section 4

15. For years, State and local governments have used tax credit bonds to fund specific types of Federally subsidized projects. Holders of such bonds receive Federal tax credits in lieu of interest (§54). The TCJA affects the use of these bonds by:

a. Incorrect. While some of these tax credit bonds have expired, the TCJA repeals them in their entirety.

b. Correct. The rules relating to tax credit bonds generally are repealed. Holders and issuers continue receiving tax credits and payments for tax credit bonds already issued.

c. Incorrect. Some types of bonds already had the option of converting to taxable and receiving direct payment from the Federal government. However, the TCJA now repeals such loans in their entirety.

d. Incorrect. While the volume cap to issue some of these bonds has been fully used, the TCJA repeals them in their entirety.

16. While most businesses can carry back net operating losses for two years or forward for 20 years, under a special rule, life insurance companies can carry them back for three years or forward for 15 years. The TCJA changes this special treatment by:

a. Incorrect. Under the TCJA, life insurance companies are only permitted to carry net operating losses back two tax years in conformity with the general net operating loss carryover rules.

b. Incorrect. The TCJA does not eliminate net operating losses for life insurance companies but conforms them to the general net operating loss carryover rules.

c. Incorrect. Under the TCJA, life insurance companies are only permitted to carry net operating losses forward 20 tax years in conformity with the general net operating loss carryover rules.

d. Correct. Under the TCJA, life insurance companies are only allowed to carry net operating losses back up to two tax years (not three) or forward up to 20 tax years (not 15), in conformity with the general net operating loss carryover rules.[p.47]

17. Insurance companies can elect to take a deduction equal to the difference between discounted and undiscounted reserves. Those that so elect must make a special estimated tax payment equal to the attributable tax benefit. The TCJA changes this special estimated tax payment by:

a. Correct. The TCJA repeals the elective deduction and related special estimated tax payment rules.

b. Incorrect. The special estimated payment is not doubled by the TCJA. Instead, the elected deduction and special estimated payment rules are repealed.

c. Incorrect. The time period for the elected deduction is not changed by the TCJA. Instead, the elected deduction and special estimated payment rules are repealed.

d. Incorrect. The application of the special election was not expanded to all businesses. Instead, the elected deduction and special estimated payment rules are repealed.[p.51]

18. While the annual deduction allowed to publicly traded C corporations for compensation paid with respect to certain highly paid officers is limited to $1 million, no parallel limitation applies to tax-exempt organizations. How did the TCJA, change this rule?

a. Incorrect. The TCJA did not exempt tax-exempt organizations from the executive compensation excise tax.

b. Incorrect. The TCJA did not change the definition of unrelated business taxable income because of such compensation.

c. Incorrect. An exempt organization does not jeopardize its tax exempt status of paying compensation in excess of $1 million to any key employee.

d. Correct. An applicable tax-exempt organization is now liable for a 21% excise tax on any annual remuneration in excess of $1 million paid to any of its five highest-paid employees. [p.53]

19. A foreign tax credit is allowed to a domestic corporation that owns at least 10% of a foreign corporation from which it receives a dividend (§902). This credit (often called the "deemed-paid" credit) has been much criticized and the TCJA:

a. Correct. The TCJA repealed the §902 deemed-paid foreign tax credit.

b. Incorrect. The TCJA did not change the ownership percentage. In any event, the deemed-paid foreign tax credit is repealed.

c. Incorrect. The credit was not converted to a deduction by the TCJA.

d. Incorrect. The TCJA could not place a limit on the credit but repealed it and its entirety. [p.60]

20. While certain organizations are exempt from Federal income tax (§501(a)), the exemption does not extend to an organization's unrelated trade or business income. However, an exempt organization may take a deduction of $1000 in calculating unrelated business taxable income (UBTI). The TCJA clarifies the application of this deduction by:

a. Correct. The TCJA requires that the UBTI for each separate business first be calculated and then aggregated before application of the $1000 deduction.

b. Incorrect. Aggregation of the UBTI of all businesses is required prior to the application of the deduction

c. Incorrect. The deduction is not repealed by the TCJA.

d. Incorrect. The TCJA does not prevent an organization from using a deduction from one taxable year to offset income from the same unrelated trade or business activity in another taxable year. [p.62]

Glossary

Adjusted gross income (AGI): Total income reduced by allowable adjustments, such as for an IRA, student loan interest, alimony, and Keogh deductions. The AGI is important in determining whether various tax benefits are phased out.

Alternative minimum tax: A tax triggered when certain tax benefits reduce regular income tax below a certain threshold.

Bankruptcy: Typically, a formal petition filed in Bankruptcy Court under Chapter 7, 11, or 13.

Earned income: Income from personal services as compared to income generated from property or other sources. It includes wages, salaries, tips, and self-employment earnings.

Expensing: A reference to §179 expense deduction.

Filing status: Determines the rate at which income is taxed. The five filing statuses are: single, married filing a joint return, married filing a separate return, head of household, and qualifying widow(er) with dependent child.

Gross income: Money, goods, services, and property a person receives that must be reported on a tax return. Includes unemployment compensation and certain scholarships. It does not include welfare benefits and nontaxable Social Security benefits.

Head of household: Head of household is a federal income tax filing status available to unmarried taxpayers that can claim a dependent as a "qualifying child" or qualifying relative."

Improvement: Expenditure for the correction of the defect in property that extends its useful life or improves its value. Unlike some repairs, improvements cannot be deducted by the taxpayer.

Net operating loss: A business loss that exceeds current income and may be carried back against income of prior years or carryforward as a deduction against future income.

Placed in service: When property is available for use.

S corporation: A particular type of corporation established under the Code that is taxed like but not as a partnership.

Standard deduction: Reduces the income subject to tax and varies depending on filing status, age, blindness, and dependency.

Tax year: The calendar, fiscal, or hybrid year adopted by the taxpayer or required by tax law for determining annual income.

Unemployment compensation: Funds received under federal or state law to compensate for unemployment. Unemployment compensation is now taxable.

Index

Qualified Assessment

Tax Cuts and Jobs Act Summary
Course # 8182608, Version 2003
Publication/Revision Date:
March 2020

Course Expiration Date

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1. Richard anticipates reporting a taxable income of $180,000 for 2018. When he files his federal income taxes as a single taxpayer, of the following marginal income tax rate brackets, he would be taxed at the:

   a. 22% rate.
   b. 24% rate.
   c. 32% rate.
   d. 35% rate.

2. In 2020, Sam expects to earn $315,200 and anticipates filing married jointly. Given this information, what would be the status of his personal exemptions with the enactment of the TCJA?

   a. His personal exemptions would remain in place without regard to AGI.
   b. His personal exemptions would be completely eliminated.
   c. His personal exemptions would be reduced by 2% of each $2,500 in excess of AGI above a threshold amount.
   d. His personal exemptions would be reduced by 4% of each $2,500 in excess of AGI above a threshold amount.

3. William is single and will earn about $70,000 in 2020. He asks how the TCJA would affect his AMT exemption. You should inform him that:

   a. His AMT exemption has been increased to $70,300 .
   b. Because of William's earnings, his AMT exemption amount will be subject to a 25% phased out.
   c. His AMT exemption must be patched periodically by Congress is not indexed to inflation.
   d. His AMT exemption is completely eliminated for 2018 and thereafter.

4. Carol and David, two moderate-income clients with two young children, want to know how the TCJA affects their use of the child tax credit. You should explain that it:

   a. Makes the increased child tax credit permanent.
   b. Modified the credit to only apply to 15% of earned income in excess of $8,500.
   c. Increased the credit to $2,000 per qualifying child through 2025.
   d. Repeals the child tax credit.

5. Fred plans to send his young daughter to parochial elementary and secondary school. However, it will be expensive, and he is looking for ways to save the tuition. You should inform Fred that, under the TCJA, §529 savings plans:

   a. Can only cover qualified higher education expenses.
   b. Are not available for private schools.
   c. Are suspended for 5 years.
   d. Can now cover religious elementary or secondary school expenses.

6. Scott obtained a student loan of $40,000 to finish his last year at Caltech and become an engineer. In 2020, he was totally and permanently disabled while working on a project and can no longer make payments. Under the TCJA, he should consider dealing with the student loan by:

   a. Filing bankruptcy.
   b. Seeking a loan discharge, since it will not be included in his income.
   c. Seeking additional financial assistance.
   d. Having Medicare pay the loan.

7. Mike is an upper-income taxpayer and itemizes but, his deductions have always been reduced by the 3% overall limitation under §68. In 2020, the TCJA might offer Mike some relief because it:

   a. Temporarily repealed the overall limitation on itemized deductions.
   b. Doubled the number of itemized deductions for individuals.
   c. Provides that §68 only applies to corporations.
   d. Increased the standard deduction to include itemized deductions.

8. You are on a tax panel for a group of homeowners. One individual wants to know what kind of items would most likely enable him to fully qualify for the home mortgage interest deduction in 2020. You inform him that one such item would be a:

   a. $750,000 purchase money loan on a residence.
   b. $100,000 in home equity indebtedness.
   c. Debt used to buy real estate.
   d. Second mortgage.

9. Erwin is an enrolled agent operating his tax business as a sole proprietor. Recently, he has been busy listing deductions for his clients that have been suspended in 2018 by the TCJA. However, which of following suspended deductions is most likely to affect Erwin's relationship with his clients:

   a. Hobby expenses.
   b. Tax preparation expenses.
   c. Investment fees.
   d. Trustee's fees for an IRA.

10. Marge will divorce in 2020 and expects to receive substantial alimony payments. When she meets with her tax advisor, she explains to Marge that under the TCJA such payments will be treated as:

    a. Qualified dependency support.
    b. Includable in the payor's income.
    c. Deductible by the payor.
    d. Income to her.

11. Ralph and Jan, a married couple, have been considering a marital deduction trust for several years to save on estate taxes. However, they may wish to reconsider their plan in light of the TCJA:

    a. Eliminating marital deduction trusts.
    b. Suspending the individual alternative minimum tax.
    c. Repealing estate taxes.
    d. Doubling the base applicable exclusion amount.

12. Peter is deliberating upon what type of entity he wants for his small computer systems design firm. He is thinking about organizing as an S corporation and seeks your advice. You would explain to him that he might find it beneficial to organize as a C corporation since:

    a. A C corporation allows shareholders to deduct personal losses.
    b. A C corporation distributes its profits to shareholders with a single tax.
    c. A C corporation eliminates unreasonable compensation problems.
    d. The TCJA has reduced the C corporate rate to 21%.

13. Delbert has chosen to purchase, and expense used equipment he will place in service in his business. Under §179, he may elect to treat the permitted expensing amount as:

    a. An immediate deduction.
    b. A 25% per year tax credit.
    c. Capitalized.
    d. An amortization of the equipment's cost.

14. Jerry wants to promote his business with some great entertainment targeting potential customers. As his advisor, you should warn him that of the following general categories of entertainment expense which is disallowed as a result of the TCJA?

    a. Food associated with operating a business.
    b. Beverages associated with operating a business.
    c. First class travel.
    d. All activities considered to be entertainment.

15. With many employee "perks" being curtailed by the TCJA, John is frustrated in his search for tax-favored benefits to offer his employees. You should explain to him that the TCJA now allows:

    a. An expanded bicycle commuting reimbursement exclusion.
    b. A credit for employee entertainment facilities.
    c. A credit for paid family and medical leave.
    d. An improved moving expense reimbursement exclusion.

16. You are reviewing the numerous detailed insurance changes made by the TCJA with your client, Dianne, who has just started a small life insurance company. The provision most likely to have an immediate impact on her young company is:

    a. The change in the computation of reserves.
    b. The repeal of the special deduction for small life insurance companies.
    c. The special distribution rule for pre-1984 accounts.
    d. The tax reporting of life settlement transactions.

17. Mike is a client and a director of a large tax-exempt organization that has recently come under media attack for excessive compensation. You should alert Mike that under the TCJA an exempt organization can:

    a. Make tax-exempt qualified equity grants to employees.
    b. Use performance-based compensation.
    c. Be liable for a 21% excise tax on compensation over $1 million.
    d. Not use parachute payments.

18. Jake is an international banker and wants to know if any TCJA provision could substantially affect the flow of funds in his industry. Of the many international TCJA provisions, the one most likely to have a major an immediate effect Jake's industry is:

    a. Deemed repatriation of deferred foreign income.
    b. Foreign-source dividends deduction.
    c. Domestic taxable income offset election.
    d. Jakes place of residence.

19. Jim owns an auto dealership in California but, his daughter Jane lives in Paris with John, her French boyfriend. To avoid U.S. taxation, John cannot conduct any U.S. trade or business. As a result, under the TCJA, John should not:

   a. Marry Jane.
   b. Visit the United States for more than 30 days.
   c. Buy a vehicle from Jim.
   d. Sell a partnership interest in Jim's business.

20. Frank is the trustee of a large private college with a majority of U.S. tuition paying students. Over the years, you have helped him navigate the complex tax rules surrounding such institutions. Because of the TCJA, you should schedule a meeting with Frank to discuss the TCJA's :

   a. Imposition of a 1.4% excise tax on net investment income.
   b. Repeal of the unrelated business income tax.
   c. Exemption of college and university investment income.
   d. Provision of a $100,000 standard deduction.

Answer Sheet

Tax Cuts and Jobs Act Summary
Course # 8182608, Version 2003
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Course Evaluation
Tax Cuts and Jobs Act Summary
Course # 8182608, Version 2003

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