RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

"Recent developments are just like ancient history, except they happened less long ago."

By

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Note: This outline was prepared jointly with Professor Cassady V. ("Cass") Brewer of the Georgia State University College of Law, Atlanta, GA.

On February 9, 2018, the President signed the Bipartisan Budget Act of 2018, Pub. L. No. 115-123. This outline summarizes the changes made by this legislation that, in our judgment, are the most important. The outline does not attempt to list the provisions of the legislation comprehensively or to explain them in detail. Readers should note that many provisions of the Bipartisan Budget Act of 2018 apply retroactively to 2017.

I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

C. Reasonable Compensation

D. Miscellaneous Deductions

E. Depreciation & Amortization

1. Certain depreciation and amortization provisions of the Bipartisan Budget Act of 2018:

a. We suppose it makes sense that racehorses have a swift recovery period. The Bipartisan Budget Act of 2018, § 40304, retroactively extended the classification of racehorses as 3-year MACRS property so that the classification applies to racehorses placed in service before 2018. A racehorse placed in service after 2017 qualifies for the 3-year recovery period only if it is more than two years old when placed in service.

b. Good news for those who placed motorsports entertainment complexes in service during 2017. The Bipartisan Budget Act of 2018, § 40305, retroactively extended the § 168(e)(3)(C)(ii) classification of motorsports entertainment complexes as 7-year property to include property placed in service through December 31, 2017. *See* § 168(i)(15)(D). Such property is depreciable over a 7-year recovery period using the straight-line method.

c. A portion of the cost of certain mine safety equipment can be treated as a current deduction through 2017. The Bipartisan Budget Act of 2018, § 40307, retroactively extended the election under § 179E to treat 50 percent of the cost of any qualified advanced mine safety equipment property as an expense in the tax year in which the equipment is placed in service. The election is available for qualifying property placed in service before January 1, 2018.

F. Credits

1. Employers who retained employees despite becoming inoperable in areas affected by Hurricanes Harvey, Irma, or Maria are eligible for a 40 percent employee retention credit. The Disaster Relief and Airport and Airway Extension Act of 2017 ("2017 Disaster Relief Act"), Pub. L. No. 115-63, was signed by the President on September 29, 2017. Section 503 of the 2017 Disaster Relief Act provides that an "eligible employer" can include the "Hurricane Harvey employee retention credit" among the credits that are components of the general business credit under § 38(b). The credit is equal to 40 percent of "qualified wages" for each "eligible employee." The cap on the amount of qualified wages that can be taken into account is $6,000. Thus, the maximum credit per employee is $2,400. An *eligible employer* is an employer that conducted an active trade or business on a specified date in the Hurricane Harvey disaster zone, Hurricane Irma disaster zone, or Hurricane Maria disaster zone, if the trade or business became inoperable on any day after the specified date and before January 1, 2018, as a result of damage sustained by the relevant hurricane. The specified dates are August 23, 2017 (Harvey), September 4, 2017 (Irma), and September 16, 2017 (Maria). The term *eligible employee* is defined as an employee whose principal place of employment with an eligible employer was in the relevant disaster zone on the relevant specified date. The term *qualified wages* means wages (as defined in § 51(c)(1), but without regard to § 3306(b)(2)(B)) paid or incurred by an eligible employer with respect to an eligible employee on any day after the relevant specified date and before January 1, 2018, during the period beginning on the date the trade or business first became inoperable at the employee's principal place of employment and ending on the date on which the trade or business resumed significant operations at the principal place of employment. Wages can be qualified wages regardless of whether the employee performed no services, performed services at a different location, or performed services at the employee's principal place of employment before significant operations resumed. An employee is not considered an eligible employee if the employer is allowed a credit with respect to the employee under § 51(a), i.e., an eligible employer cannot claim the 40 percent credit with respect to an employee for any period if the employer is allowed a Work Opportunity Tax Credit with respect to the employee under § 51 for that period.

- Section 501 of the 2017 Disaster Relief Act defines the terms Hurricane Harvey disaster area, Hurricane Irma disaster area, and Hurricane Maria disaster area as an area with respect to which the President has declared a major disaster by reason of the relevant hurricane before October 17, 2017. (*Note:* the date originally in the 2017 Disaster Relief Act was September 21, 2017. This date was changed to October 17, 2017, by the Bipartisan Budget Act of 2018, Division B, § 20201, Pub. L. No. 115-123, which was signed by the President on February 9, 2018.) The terms Hurricane Harvey disaster zone, Hurricane Irma disaster zone, and Hurricane Maria disaster zone are defined as the portion of the relevant disaster area determined by the President to warrant individual or individual and public assistance from the federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of the relevant hurricane.

a. Congress has provided a similar credit to employers who retained employees despite becoming inoperable in areas affected by California wildfires. The Bipartisan Budget Act of 2018, Pub. L. No. 115-123, § 20103 of Division B, provides that an "eligible employer" can include the "California wildfire employee retention credit" among the credits that are components of the general business credit under § 38(b). This credit is essentially the same as the "Hurricane Harvey employee retention credit" enacted as part of the 2017 Disaster Relief Act, except that it applies to a different category of employers. For purposes of the California wildfire employee retention credit, an *eligible employer* is one that conducted an active trade or business on October 8, 2017, in the California wildfire disaster zone whose trade or business was inoperable on any day after October 8, 2017, and before January 1, 2018, as a result of damage sustained by reason of wildfires with respect to which the President declared a major disaster under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. Like the Hurricane Harvey employee retention credit, the California wildfire employee retention credit is a credit equal to 40 percent of "qualified wages" (up to $6,000) for each "eligible employee," so that the maximum credit per employee is $2,400.

- The Bipartisan Budget Act of 2018 defines the term "California wildfire disaster zone" as the portion of the California wildfire disaster area determined by the President to warrant individual or individual and public assistance from the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of wildfires in California. The term "California wildfire disaster area" is defined as an area with respect to which the President declared a major disaster from January 1, 2017, through January 18, 2018, under section 401 of the Stafford Act by reason of wildfires in California.

III. INVESTMENT GAIN

IV. COMPENSATION ISSUES

A. Fringe Benefits

B. Qualified Deferred Compensation Plans

1. Retirement plans can make loans and hardship distributions to victims of Hurricanes Harvey and Irma. Announcement 2017-11, 2017-39 I.R.B. 255 (8/30/17) and Announcement 2017-13, 2017-40 I.R.B. 271 (9/12/17). Section 401(k) plans and similar employer-sponsored retirement plans can make loans and hardship distributions to victims of Hurricanes Harvey and Irma. Participants in § 401(k) plans, employees of public schools and tax-exempt organizations with § 403(b) tax-sheltered annuities, as well as state and local government employees with § 457(b) deferred-compensation plans, may be eligible to take advantage of these streamlined loan procedures and liberalized hardship distribution rules. IRA participants are barred from taking out loans, but may be eligible to receive distributions under liberalized procedures. Pursuant to this relief, an eligible plan will not be treated as failing to satisfy any requirement under the Code or regulations merely because the plan makes a loan, or a hardship distribution for a need arising from Hurricanes Harvey or Irma, to an employee, former employee, or certain family members of employees whose principal residence or place of employment was in one of the Texas counties (as of August 23, 2017) or Florida counties (as of September 4, 2017) identified for individual assistance by the Federal Emergency Management Agency (FEMA) because of the devastation caused by Hurricanes Harvey or Irma. Similar relief applies with respect to additional areas identified by FEMA for individual assistance after August 23, 2017 (in the case of Harvey) or September 4, 2017 (in the case of Irma). To qualify for this relief, hardship withdrawals must be made by January 31, 2018. To facilitate access to plan loans and distributions, the IRS will not treat a plan as failing to follow procedural requirements imposed by the terms of the plan for plan loans or distributions merely because those requirements are disregarded for any period beginning on or after August 23, 2017 (in the case of Harvey) or September 4, 2017 (in the case of Irma) and continuing through January 31, 2018, provided the plan administrator (or financial institution in the case of IRAs) makes a good-faith diligent effort under the circumstances to comply with those requirements. As soon as practicable, the plan administrator (or financial institution in the case of IRAs) must make a reasonable attempt to assemble any forgone documentation.

- This relief means that a retirement plan can allow a victim of Hurricanes Harvey or Irma to take a hardship distribution or borrow up to the specified statutory limits from the victim's retirement plan. It also means that a person who lives outside the disaster area can take out a retirement plan loan or hardship distribution and use it to assist a son, daughter, parent, grandparent or other dependent who lived or worked in the disaster area.

- A plan is allowed to make loans or hardship distributions before the plan is formally amended to provide for such features. Plan amendments to provide for loans or hardship distributions must be made no later than the end of the first plan year beginning after December 31, 2017. In addition, the plan can ignore the reasons that normally apply to hardship distributions, thus allowing them, for example, to be used for food and shelter.

- Except to the extent the distribution consists of already-taxed amounts, a hardship distribution made pursuant to this relief will be includible in gross income and generally subject to the 10-percent additional tax of § 72(t).

a. Congress makes access to retirement plan funds even easier for victims of Hurricanes Harvey, Irma, and Maria. The Disaster Relief and Airport and Airway Extension Act of 2017 ("2017 Disaster Relief Act"), Pub. L. No. 115-63, was signed by the President on September 29, 2017. Section 502 of the 2017 Disaster Relief Act provides special rules that apply to distributions from qualified employer plans and IRAs and to loans from qualified employer plans for victims of Hurricanes Harvey, Irma, and Maria. To a large extent, these rules supersede those in Announcement 2017-11, 2017-39 I.R.B. 255 (8/30/17), and Announcement 2017-13, 2017-40 I.R.B. 271 (9/12/17).

Qualified Hurricane Distributions. Section 502(a) of the 2017 Disaster Relief Act provides four special rules for "qualified hurricane distributions." **First**, the legislation provides that qualified hurricane distributions up to an aggregate amount of $100,000 are not subject to the normal 10-percent additional tax of § 72(t) that applies to distributions to a taxpayer who has not reached age 59-1/2. **Second**, the legislation provides that, unless the taxpayer elects otherwise, any income resulting from a qualified hurricane distribution is reported ratably over the three-year period beginning with the year of the distribution. **Third**, the legislation permits the recipient of a qualified hurricane distribution to contribute up to the amount of the distribution to a qualified employer plan or IRA that would be eligible to receive a rollover contribution of the distribution. The contribution need not be made to the same plan from which the distribution was received, and must be made during the three-year period beginning on the date of the distribution. If contributed within the required three-year period, the distribution and contribution are treated as made in a direct trustee-to-trustee transfer within 60 days of the distribution. The apparent intent of this rule is to permit the taxpayer to exclude the distribution from gross income to the extent it is recontributed within the required period. Because the recontribution might take place in a later tax year than the distribution, presumably a taxpayer would include the distribution in gross income in the year received and then file an amended return for the distribution year upon making the recontribution. **Fourth**, qualified hurricane distributions are not treated as eligible rollover distributions for purposes of the withholding rules, and therefore are not subject to the normal 20 percent withholding that applies to eligible rollover distributions under § 3405(c). A *qualified hurricane distribution* is defined as any distribution from an eligible retirement plan as defined in § 402(c)(8)(B) (which includes qualified employer plans and IRAs) made before January 1, 2019, and (1) on or after August 23, 2017, to an individual whose principal place of abode on that date was located in the Hurricane Harvey disaster area and who sustained an economic loss by reason of Hurricane Harvey, (2) on or after September 4, 2017, to an individual whose principal place of abode on that date was located in the Hurricane Irma disaster area and who sustained an economic loss by reason of Hurricane Irma, or (3) on or after September 16, 2017, to an individual whose principal place of abode on that date was located in the Hurricane Maria disaster area and who sustained an economic loss by reason of Hurricane Maria.

Recontributions of Withdrawals Made for Home Purchases. Section 502(b) of the 2017 Disaster Relief Act permits an individual who received a "qualified distribution" to contribute up to the amount of the distribution to a qualified employer plan or IRA that would be eligible to receive a rollover contribution of the distribution. A qualified distribution is a hardship distribution that an individual received from a qualified employer plan or IRA after February 28, 2017, and before September 21, 2017, that was to be used to purchase or construct a principal residence in the Hurricane Harvey, Irma, or Maria disaster areas that was not purchased or constructed on account of the hurricanes. The contribution need not be made to the same plan from which the distribution was received, and must be made during the period beginning on August 23, 2017, and ending on February 28, 2018. The distribution and contribution are treated as made in a direct trustee-to-trustee transfer within 60 days of the distribution. The apparent intent of this rule is to permit the taxpayer to exclude the distribution from gross income to the extent it is recontributed within the required period.

Loans. For victims of Hurricanes Harvey, Irma, or Maria, section 502(c) of the 2017 Disaster Relief Act increases the limit on loans from qualified employer plans and permits repayment over a longer period of time. Normally, under § 72(p), a loan from a qualified employer plan is treated as a distribution unless it meets certain requirements. One requirement is that the loan must not exceed the lesser of (1) $50,000 or (2) the greater of one-half of the present value of the employee's nonforfeitable accrued benefit or $10,000. A second requirement is that the loan must be repaid within five years. In the case of a loan made to a "qualified individual" during the period from September 29, 2017 (the date of enactment) through December 31, 2018, the legislation increases the limit on loans to the lesser of (1) $100,000 or (2) the greater of *all* of the present value of the employee's nonforfeitable accrued benefit or $10,000. The legislation also provides that, if a qualified individual has an outstanding plan loan on August 23, 2017 (for Harvey victims), September 4, 2017 (for Irma victims), or September 16, 2017 (for Maria victims) with a due date for any repayment on or before December 31, 2018, the due date is delayed for one year. If an individual takes advantage of this delay, then any subsequent repayments are adjusted to reflect the delay in payment and interest accruing during the delay. This appears to require reamortization of the loan. A *qualified individual* is defined as an individual whose principal place of abode (1) was located in the Hurricane Harvey disaster area on August 23, 2017, and who sustained an economic loss by reason of Hurricane Harvey, (2) was located in the Hurricane Irma disaster area on September 4, 2017, and who sustained an economic loss by reason of Hurricane Irma, or (3) was located in the Hurricane Maria disaster area on September 16, 2017, and who sustained an economic loss by reason of Hurricane Maria.

Hurricane Harvey, Irma, and Maria Disaster Areas. Section 501 of the 2017 Disaster Relief Act defines the Hurricane Harvey disaster area, Hurricane Irma disaster area, and Hurricane Maria disaster area as an area with respect to which the President has declared a major disaster by reason of the relevant hurricane before October 17, 2017. (*Note:* the date originally in the 2017 Disaster Relief Act was September 21, 2017. This date was changed to October 17, 2017, by the Bipartisan Budget Act of 2018, Division B, § 20201, Pub. L. No. 115-123, which was signed by the President on February 9, 2018.)

b. Congress has enacted similar rules to allow easier access to retirement funds for those affected by California wildfires. The Bipartisan Budget Act of 2018, Pub. L. No. 115-123, § 20102 of Division B, provides those affected by California wildfires with the same special rules for distributions from qualified employer plans and IRAs and for loans from qualified employer plans that Congress previously enacted as part of the 2017 Disaster Relief Act for those affected by Hurricanes Harvey, Irma, and Maria.

Qualified Wildfire Distributions. The legislation provides that "qualified wildfire distributions" up to an aggregate limit of $100,000 are not subject to the normal 10-percent additional tax of § 72(t), are to be included in gross income over a three-year period unless the recipient elects otherwise, can be recontributed to an eligible plan within three years and thereby treated as tax-free rollovers, and are not subject to the normal 20 percent withholding that applies to eligible rollover distributions under § 3405(c). A *qualified wildfire distribution* is defined as any distribution from an eligible retirement plan as defined in § 402(c)(8)(B) (which includes qualified employer plans and IRAs) made on or after October 8, 2017, and before January 1, 2019, to an individual whose principal place of abode during any portion of the period from October 8, 2017, to December 31, 2017, was located in the California wildfire disaster area and who sustained an economic loss by reason of the wildfires.

Recontributions of Withdrawals Made for Home Purchases. The legislation permits an individual who received a "qualified distribution" to contribute up to the amount of the distribution to a qualified employer plan or IRA that would be eligible to receive a rollover contribution of the distribution. A qualified distribution is a hardship distribution that an individual received from a qualified employer plan or IRA after March 31, 2017, and before January 15, 2018, that was to be used to purchase or construct a principal residence in the California wildfire disaster area that was not purchased or constructed on account of the wildfires. The contribution need not be made to the same plan from which the distribution was received, and must be made during the period beginning on October 8, 2017, and ending on June 30, 2018. The distribution and contribution are treated as made in a direct trustee-to-trustee transfer within 60 days of the distribution. This special rule permits the taxpayer to exclude the distribution from gross income to the extent it is recontributed within the required period.

Loans. The legislation provides those affected by California wildfires the same increased loan limit and extended repayment period that Congress previously provided in the 2017 Disaster Relief Act to those affected by Hurricanes Harvey, Irma, and Maria. In the case of a loan made to a "qualified individual" during the period from February 9, 2018 (the date of enactment) through December 31, 2018, the legislation increases the limit on loans to the lesser of (1) $100,000 or (2) the greater of *all* of the present value of the employee's nonforfeitable accrued benefit or $10,000. The legislation also provides that, if a qualified individual has an outstanding plan loan on or after October 8, 2017, with a due date for any repayment on or before December 31, 2018, the due date is delayed for one year. A *qualified individual* is any individual whose principal place of abode during any portion of the period from October 8, 2017, to December 31, 2017, was located in the California wildfire disaster area and who sustained an economic loss by reason of the wildfires.

California Wildfire Disaster Area. The Bipartisan Budget Act of 2018 defines the term "California wildfire disaster area" as an area with respect to which the President declared a major disaster from January 1, 2017, through January 18, 2018, under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of wildfires in California.

C. Nonqualified Deferred Compensation, Section 83, and Stock Options

D. Individual Retirement Accounts

V. PERSONAL AND INDIVIDUAL INCOME AND DEDUCTIONS

A. Rates

B. Miscellaneous Income

1. An exclusion from gross income for wrongfully incarcerated individuals. The 2015 PATH Act, § 304, added to the Code § 139F, which excludes from the gross income of an individual who is convicted of a criminal offense under federal or state law and wrongfully incarcerated any civil damages, restitution, or other monetary award relating to the individual's incarceration. An individual was wrongfully incarcerated if the individual is pardoned, granted clemency, or granted amnesty for the offense because the individual was innocent, or if the conviction is reversed or vacated and the charging instrument is then dismissed or the individual is found not guilty at a new trial. The new provision applies to taxable years beginning before, on, or after December 18, 2015, the date of enactment. A special rule allows individuals to make a claim for credit or refund of any overpayment of tax resulting from the exclusion, even if the claim would normally be barred by operation of any law or rule of law (including res judicata), if the claim for credit or refund is filed before the close of the one-year period beginning on December 18, 2015.

a. Congress has extended to December 18, 2018, the time within which individuals can file claims for refund based on the § 139F exclusion. The Bipartisan Budget Act of 2018, § 41103, extends the time within which individuals who are eligible for the Code § 139F exclusion can file a claim for credit or refund of any overpayment of tax resulting from the exclusion. Pursuant to this amendment, even if an individual's claim was barred as of December 18, 2015, by operation of any law or rule of law (including res judicata), the individual can make a claim for credit or refund based on the § 139F exclusion if the claim is filed before the close of the three-year period beginning on December 18, 2015. Thus, individuals have until December 18, 2018, to file such claims.

2. Congress has extended through 2017 the exclusion for discharge of qualified principal residence indebtedness. The Bipartisan Budget Act of 2018, § 40201, retroactively extended through December 31, 2017 the § 108(a)(1)(E) exclusion for up to $2 million ($1 million for married individuals filing separately) of income from the cancellation of qualified principal residence indebtedness.

C. Hobby Losses and § 280A Home Office and Vacation Homes

D. Deductions and Credits for Personal Expenses

1. Deducting casualty losses in areas affected by Hurricanes Harvey, Irma, and Maria just got easier. The Disaster Relief and Airport and Airway Extension Act of 2017 ("2017 Disaster Relief Act"), Pub. L. No. 115-63, was signed by the President on September 29, 2017. Section 504(b) of the 2017 Disaster Relief Act provides special rules for disaster losses in specified areas that are attributable to Hurricanes Harvey, Irma, or Maria. Normally, a personal casualty loss is deductible only to the extent that it exceeds $100 and only to the extent the sum of all personal casualty losses exceeds 10 percent of adjusted gross income. The 2017 Disaster Relief Act provides that a "net disaster loss" is deductible only to the extent it exceeds $500 (rather than $100) and is deductible without regard to the normal 10-percent-of-AGI threshold. An individual with a net disaster loss can deduct the sum of any non-disaster personal casualty losses, which remain subject to the $100 and 10 percent thresholds, and the net disaster loss. For example, if an individual has AGI of $90,000, a non-disaster-related casualty loss of $10,000 from the theft of a personal car, and a net disaster loss from Hurricane Harvey of $50,000, then the individual can deduct $900 of the theft loss ($10,000 reduced by $100 reduced by 10 percent of AGI) and can deduct $49,500 of the net disaster loss ($10,000 reduced by $500). The deduction for the net disaster loss is available both to those who itemize their deductions and those who do not. For those who do not itemize, the standard deduction is increased by the amount of the net disaster loss. The disallowance of the standard deduction for purposes of determining alternative minimum taxable income does not apply to this increased portion of the standard deduction.

A net disaster loss is defined as the amount by which "qualified disaster-related personal casualty losses" exceed personal casualty gains. A qualified disaster-related personal casualty loss is a loss described in § 165(c)(3) (which generally defines casualty losses) that is attributable to Hurricanes Harvey, Irma, or Maria and that arises: (1) in the Hurricane Harvey disaster area on or after August 23, 2017, (2) in the Hurricane Irma disaster area on or after September 4, 2017, or (3) in the Hurricane Maria disaster area on or after September 16, 2017. Section 501 of the 2017 Disaster Relief Act defines each of these areas as an area with respect to which the President has declared a major disaster by reason of the relevant hurricane before October 17, 2017. (*Note:* the date originally in the 2017 Disaster Relief Act was September 21, 2017. This date was changed to October 17, 2017, by the Bipartisan Budget Act of 2018, Division B, § 20201, Pub. L. No. 115-123, which was signed by the President on February 9, 2018.)

a. The IRS has provided safe harbor methods for determining casualty and theft losses for personal-use residential real property and personal belongings. Rev. Proc. 2018-8, 2018-2 I.R.B. 286 (12/13/17). This revenue procedure provides safe harbor methods that individual taxpayers can use in determining the amount of their casualty and theft losses for their personal-use residential real property and personal belongings. Additional safe harbor methods are available in the case of casualty and theft losses occurring as a result of any federally declared disaster. The IRS will not challenge an individual's determination of the decrease in fair market value of personal-use residential real property or personal belongings if the individual qualifies for and uses one of the safe harbor methods described in the revenue procedure. The revenue procedure is effective December 13, 2017.

b. An additional safe harbor for personal-use residential real property affected by Hurricanes Harvey, Irma, or Maria. Rev. Proc. 2018-9, 2018-2 I.R.B. 290 (12/13/17). This revenue procedure provides the Cost Indexes Safe Harbor Method that individual taxpayers may use in determining the amount of their casualty losses pursuant to Code § 165 for their personal-use residential real property damaged or destroyed as a result of Hurricane and Tropical Storm Harvey, Hurricane Irma, and Hurricane Maria (the "2017 Hurricanes"). Specifically, this revenue procedure provides a safe harbor method that individuals may use to determine the decrease in fair market value of their personal-use residential real property on their U.S. income tax returns filed with the IRS. The IRS will not challenge an individual's determination of the decrease in fair market value of personal-use residential real property attributable to one of the 2017 Hurricanes if the individual qualifies for and uses the safe harbor method described in the revenue procedure. The revenue procedure is effective for losses that are attributable to the 2017 Hurricanes and that arose after August 22, 2017 in specified areas.

c. Congress has enacted legislation to make deducting casualty losses easier in areas affected by California wildfires. The Bipartisan Budget Act of 2018, § 20104(b) of Division B, provides the same special rules for disaster losses that are attributable to California wildfires as it previously provided for disaster losses attributable to Hurricanes Harvey, Irma, and Maria. Specifically, the legislation provides that a "net disaster loss" is deductible only to the extent it exceeds $500 (rather than $100) and is deductible without regard to the normal 10-percent-of-AGI threshold. The deduction for the net disaster loss is available both to those who itemize their deductions and those who do not. For those who do not itemize, the standard deduction is increased by the amount of the net disaster loss. The disallowance of the standard deduction for purposes of determining alternative minimum taxable income does not apply to this increased portion of the standard deduction. A *net disaster loss* is defined as the amount by which "qualified disaster-related personal casualty losses" exceed personal casualty gains. A qualified disaster-related personal casualty loss is a loss described in § 165(c)(3) (which generally defines casualty losses) that arises in the California wildfire disaster area on or after October 8, 2017, that is attributable to the wildfires.

2. Those affected by Hurricanes Harvey, Irma, or Maria can use prior-year earned income to determine their earned income tax credit and child tax credit. The Disaster Relief and Airport and Airway Extension Act of 2017 ("2017 Disaster Relief Act"), Pub. L. No. 115-63, was signed by the President on September 29, 2017. Section 504(c) of the 2017 Disaster Relief Act provides that a "qualified individual" can elect to use prior-year earned income for purposes of determining the individual's earned income tax credit under § 32 and child tax credit under § 24. The election is available for qualified individuals whose earned income for the tax year that includes the "applicable date" is lower than their earned income for the preceding tax year. The applicable date is August 23, 2017, for Hurricane Harvey, September 4, 2017, for Hurricane Irma, and September 16 for Hurricane Maria. If a qualified individual makes this election, it applies for purpose of both the earned income tax credit and the child tax credit. For married couples filing a joint return, the election is available if either spouse is a qualified individual, and the earned income for the preceding year is the sum of the earned income in the preceding year of both spouses. A *qualified individual* is defined as a "qualified Hurricane Harvey individual," a "qualified Hurricane Irma individual," or a "qualified Hurricane Maria individual." A qualified Hurricane Harvey individual is defined as an individual whose principal place of abode on August 23, 2017 was located (1) in the Hurricane Harvey disaster zone, or (2) outside the Hurricane Harvey disaster zone, but within the Hurricane Harvey disaster area if the individual was displaced from his or her principal place of abode by reason of Hurricane Harvey. The terms "qualified Hurricane Irma individual" and "qualified Hurricane Maria individual" are defined in a similar manner but with dates of September 4, 2017, and September 16, 2017, respectively.

- Section 501 of the 2017 Disaster Relief Act defines the terms Hurricane Harvey disaster area, Hurricane Irma disaster area, and Hurricane Maria disaster area as an area with respect to which the President has declared a major disaster by reason of the relevant hurricane before October 17, 2017. (*Note:* the date originally in the 2017 Disaster Relief Act was September 21, 2017. This date was changed to October 17, 2017, by the Bipartisan Budget Act of 2018, Division B, § 20201, Pub. L. No. 115-123, which was signed by the President on February 9, 2018.) The terms Hurricane Harvey disaster zone, Hurricane Irma disaster zone, and Hurricane Maria disaster zone are defined as the portion of the relevant disaster area to warrant individual or individual and public assistance from the federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of the relevant hurricane.

a. Those affected by California wildfires also can use prior year earned income to determine their earned income tax credit and child tax credit. The Bipartisan Budget Act of 2018, § 20104(c) of Division B, provides that a "qualified individual" can elect to use prior-year earned income for purposes of determining the individual's earned income tax credit under § 32 and child tax credit under § 24. The election is available for qualified individuals whose earned income for the tax year that includes any portion of the period from October 8, 2017, to December 31, 2017, is lower than their earned income for the preceding tax year. A *qualified individual* is defined as an individual whose principal place of abode during any portion of the period from October 8, 2017, to December 31, 2017, was located (1) in the California wildfire disaster zone, or

(2) outside the California wildfire disaster zone, but within the California wildfire disaster area if the individual was displaced from his or her principal place of abode by reason of the wildfires.

- The Bipartisan Budget Act of 2018 defines the term "California wildfire disaster zone" as the portion of the California wildfire disaster area determined by the President to warrant individual or individual and public assistance from the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of wildfires in California. The term "California wildfire disaster area" is defined as an area with respect to which the President declared a major disaster from January 1, 2017, through January 18, 2018, under section 401 of the Stafford Act by reason of wildfires in California.

3. **Mortgage insurance premiums paid through 2017 remain deductible** The Bipartisan Budget Act of 2018, § 40202, retroactively extended through December 31, 2017, the § 163(h)(3)(E) deduction (subject to the pre-existing limitations) for mortgage insurance premiums paid or accrued in connection with acquisition indebtedness with respect to a qualified residence of the taxpayer.

4. **You might be glad you paid your child's college tuition in December 2017 rather than January 2018.** The Bipartisan Budget Act of 2018, § 40203, retroactively extended through December 31, 2017, the § 222 above-the-line deduction for individuals of a limited amount ($0, $2,000, or $4,000, depending on the taxpayer's adjusted gross income) of qualified tuition and related expenses for higher education of the taxpayer, the taxpayer's spouse, or dependents.

5. **Retroactive extension of certain deductions and credits for energy efficiency by the Bipartisan Budget Act of 2018:**

a. **A retroactive incentive for homeowners to make energy-efficient home improvements. Does this make sense?** Section 40401 of the Bipartisan Budget Act of 2018 retroactively extended the § 25C credit for 10 percent of the amount paid or incurred by a taxpayer for qualified energy efficiency improvements (such as exterior windows, exterior doors, and energy-saving roofs) and 100 percent of the amount paid or incurred by a taxpayer for residential energy property expenditures (such as high-efficiency furnaces, water heaters, and air conditioning systems). The credit is available for qualifying improvements made to a taxpayer's principal residence and is subject to a lifetime cap of $500. As extended, the credit is available for property placed in service before January 1, 2018.

b. **Congress has retroactively extended the credit for residential energy efficient property.** Section 40402 of the Bipartisan Budget Act of 2018 retroactively extended the § 25D 30 percent credit for qualified fuel cell property, qualified small wind energy property, and qualified geothermal heat pump property. The 30 percent credit is now available for property in these categories placed in service before January 1, 2020, which matches Congress's previous extension of the credit (in 2015) for solar property. The credit for all categories of eligible property (including solar) phases down to 26 percent for property placed in service after 2019 and before 2021, and to 22 percent for property placed in service after 2020 and before 2022.

c. **Congress gives a "thumbs up" to new energy efficient homes.** Section 40410 of the Bipartisan Budget Act of 2018 retroactively extended the § 45L credit of $2,000 or $1,000 (depending on the projected level of fuel consumption) an eligible contractor can claim for each qualified new energy efficient home constructed by the contractor and acquired by a person from the contractor for use as a residence during the tax year. As extended, the credit is available for homes acquired before January 1, 2018.

d. **A retroactive incentive to make commercial buildings energy efficient.** Section 40413 of the Bipartisan Budget Act of 2018 retroactively extended the § 179D deduction for the cost of energy efficient commercial building property. Generally, these are improvements deigned to reduce energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of a commercial building by 50 percent or more in comparison to certain standards. The lifetime limit on deductions under § 179D is $1.80 per square foot. As extended, the deduction is available for property placed in service before January 1, 2018.

E. **Divorce Tax Issues**

F. **Education**

G. **Alternative Minimum Tax**

VI. CORPORATIONS

VII. PARTNERSHIPS

A. Formation and Taxable Years

B. Allocations of Distributive Share, Debt, and Outside Basis

1. ♫♪You got to know when to hold'em, know when to fold'em, know when to walk away, and know when to run….♫♪ Carried interests still qualify for preferential long-term capital gain rates, but the holding period just increased to 3 years for specified interests in hedge funds and other investment partnerships. For years there has been a big brouhaha over managers of real estate, hedge fund, and other investment partnerships being taxed at preferential long-term capital gain rates (e.g., 20%) on their distributive shares of partnership income notwithstanding the fact that they received their interests in these partnerships as part of their compensation for services rendered (which compensation otherwise would be taxed at ordinary income rates). Congress and eventually President Trump have threatened for several years to take action against this "loophole." Well, at long last, Congress still has done NOTHING about it, but can claim that it did!

New § 1061. Specifically, the 2017 Tax Cuts and Jobs Act, § 13309, created new § 1061 and redesignated pre-TCJA § 1061 as § 1062. New § 1061 requires a three-year holding period for allocations of income with respect to "applicable partnership interests" to qualify for preferential long-term capital gain rates. Specifically, net long-term capital gain allocated to a partner who holds an applicable partnership interest is characterized as short-term capital gain to the extent the gain is attributable to the disposition of partnership property held by the partnership for three years or fewer. An applicable partnership interest is one that is transferred to (or is held by) a taxpayer in connection with the performance of substantial services by the taxpayer, or any other related person, in any "applicable trade or business." An applicable trade or business means any activity conducted on a regular, continuous, and substantial basis which, regardless of whether the activity is conducted in one or more entities, consists, in whole or in part, of ''raising or returning capital," and either "investing in (or disposing of) specified assets (or identifying specified assets for such investing or disposition)," or ''developing specified assets." Specified assets for this purpose generally are defined as securities, commodities, real estate held for rental or investment, cash or cash equivalents, options or derivative contracts with respect to any of the foregoing, and (*big furrowed brow here*) "an interest in a partnership to the extent of the partnership's proportionate interest in any of the foregoing" (e.g., tiered partnerships). There are significant exceptions, though, for (i) employees of another entity holding interests in a partnership that only performs services for that other entity; and (ii) partnership interests acquired for invested capital (including via a § 83(b) for a capital interest in a partnership).

What about § 1231 assets? It is unclear (at least to the authors) whether § 1061's three-year holding period rule applies to trump (*no pun intended*) quasi-capital gain treatment under § 1231. Basically, new § 1061 works by transmuting (i) otherwise net long-term capital gain (as defined in § 1222) attributable to an "applicable partnership interest" (i.e., all of a taxpayer's net long-term capital gain as normally calculated) into short-term capital gain, but (ii) only to the extent such gain exceeds net long-term capital gain (as defined in § 1222) attributable to the disposition of partnership property held by the partnership for three years or more (i.e., net long-term gain that is excluded from transmutation under § 1061). Short- and long-term capital gain (or loss) is defined under § 1222 by reference to a "capital asset" as defined in § 1221 and is determined at the partnership level. Code § 1221 excludes § 1231 assets from the definition of "capital assets." To wit, in the recent case of *CRI-Leslie, LLC v. Commissioner*, 147 T.C. No. 8 (9/7/16), the IRS was successful in arguing, over the strenuous objection of the taxpayer, that a § 1231 asset is not a "capital asset" within the meaning of § 1234A (which treats gains and losses realized upon termination of rights with respect to a "capital asset" as capital gain or loss). The taxpayer in *CRI-Leslie* had entered into a contract to sell a hotel that it owned and had received a deposit of $9.7 million. Ultimately, the buyer under the contract defaulted and forfeited the $9.7 million deposit, which was retained by the taxpayer. The hotel property was a § 1231 asset, not a capital asset. Relying upon § 1234A, the taxpayer reported the $9.7 million as net long-term capital gain. The IRS, however, asserted a deficiency based upon treating the forfeited $9.7 million deposit as ordinary income. The taxpayer argued that its characterization of the forfeited deposit as long-term capital gain was supported by the legislative history of § 1234A because, according to the taxpayer, Congress enacted § 1234A to "ensure that taxpayers received the same tax characterization of gain or loss whether the property is sold or the contract to which the property is subject is terminated." Nonetheless, the Tax Court (Judge Laro) rejected the taxpayer's argument that the legislative history of § 1234A supported the taxpayer's position. Instead, Judge Laro agreed with the IRS that "[s]ince section 1234A expressly refers to property that is 'a capital asset in the hands of the taxpayer' and no other type of property, and since property described in section 1231 is excluded explicitly from the definition of 'capital asset' in section 1221, we must conclude that the plain meaning of 'capital asset' as used in section 1234A does not extend to section 1231 property." The court was "unable find anything in the legislative history of section 1234A to support [the taxpayer's] assertion that Congress intended to include section 1231 property within its ambit." The legislative history accompanying new § 1061 likewise is bereft of any reference to § 1231 property.

What about partnership interests held by S corporations? Under § 1061(c)(4)(A), an interest in a partnership is not subject to the carried interest rule if it is held "directly or indirectly … by a corporation." Absent any limitation in the statute, the term "corporation" should include a subchapter S corporation. Has Congress left a glaring loophole?

Who cares? Isn't § 1061 just a paper tiger? New § 1061 is deserving of much more study, but we suspect that the provision will catch only those very rare taxpayers who either (i) fail to hold their carried interests for more than three years, or (ii) lack the sophisticated advice to plan around the statute. One commentator characterizes the new statute as "joke" given that most managers of real estate, hedge funds, and investment partnerships hold their carried interests for well over three years. *See* Sloan, *Carried Interest Reform is a Sham*, Washington Post, December 1, 2017. On the other hand, maybe this comment is just "fake news." New § 1061 is permanent and applies to taxable years beginning after 2017.

a. Does the word "corporation" in the Code include an S corporation? The Treasury Department and the IRS don't think so. Notice 2018-38, 2018-12 I.R.B. ___ (3/1/18). Under § 1061(c)(4)(A) as enacted by the 2017 Tax Cuts and Jobs Act, an interest in a partnership is not subject to the carried interest rule if it is held "directly or indirectly … by a corporation." In this notice, the Treasury Department and the IRS have announced that they intend to issue regulations providing guidance on § 1061 and that "those regulations will provide that the term 'corporation' for purposes of section 1061(c)(4)(A) does not include an S corporation." Other than reciting the statutory definitions of "S corporation" and "C corporation," the notice does not provide any explanation of how the regulations will arrive at that result. According to the notice, the regulations will be effective for taxable years beginning after December 31, 2017.

C. Distributions and Transactions Between the Partnership and Partners

D. Sales of Partnership Interests, Liquidations and Mergers

E. Inside Basis Adjustments

F. Partnership Audit Rules

1. Bye bye TEFRA! The Bipartisan Budget Act of 2015 § 1101, Pub. L. No. 114-74, signed by the President on 11/2/15, made sweeping changes to the partnership audit rules. The TEFRA rules (in §§ 6221-6231) and Electing Large Partnership rules (in §§ 6240-6242, 6245-6248, 6251-6252, and 6255) have been repealed and replaced in new §§ 6221-6223, 6225-6227, 6231-6235, and 6241, with an entity-level audit process that allows the IRS to assess and collect the taxes against the partnership unless the partnership properly elects out. The new rules will simplify the current complex procedures on determining who is authorized to settle on behalf of the partnership and also avoid the IRS's need to send various notices to all of the partners. Under the new provisions the IRS may reduce the potential tax rate assessed against the partnership to take into account factors such as tax-exempt partners and potential favorable capital gains tax rates. The new rules should significantly simplify partnership audits. As a result, the audit rate of partnerships might increase. Although partnerships with 100 or fewer partners can elect out of the new rules, § 6221(b), such election is not available if there is another partnership as a partner. Implementation of the new rules is deferred; the new rules apply to partnership taxable years beginning after 12/31/17. Partnership agreements should be amended to take into account these changes.

a. The early bird catches the worm (or is that eats the worm at the bottom of the tequila bottle?). T.D. 9780, Election into the Partnership Audit Regime Under the Bipartisan Budget Act of 2015, 81 F.R. 51795 (8/5/16). The Treasury and IRS have promulgated Temp. Reg. § 301.9100-22T dealing with the time, form, and manner for making an election to have the new partnership audit regime, §§ 6221-6223, 6225-6227, 6231-6235, and 6241, enacted in the Bipartisan Budget Act of 2015, apply to returns filed for tax years beginning after 11/2/15 and before 1/1/18. Under Temp Reg. § 301.9100-22T(b) an election to have the new partnership audit regime apply must be made within 30 days of the date of the written notice from the IRS that the partnership return has been selected for examination. The election must be in writing, signed by the tax matters partner, and must include the name, taxpayer identification number, address, and telephone number of the individual who signs the statement, as well as the partnership's name, taxpayer identification number, and tax year to which the statement applies. The statement must include representations that the partnership is not insolvent and does not reasonably anticipate becoming insolvent, the partnership is not currently and does not reasonably anticipate becoming subject to a title 11 bankruptcy petition, and the partnership has sufficient assets, and reasonably anticipates having sufficient assets, to pay the potential imputed underpayment that may be determined during the partnership examination. The election must designate the partnership representative (§ 6223). An election may not be revoked without the IRS's consent. Temp. Reg. § 301.9100-22T(c) allows a partnership that has not been issued a notice of selection for examination to make an election with respect to a partnership return for the purpose of filing an administrative adjustment request under § 6227 (as amended); this election may only be made after 12/31/17. The temporary regulation is effective on 8/5/16.

b. The "thawed" version of the centralized partnership audit rules is here, and all 277 pages of the new rules still stink for partnerships and partners (but at least the regs didn't change much, and the Federal Register version is only 69 pages)! REG-136118-15, Centralized Partnership Audit Regime, 82 F.R. 27334-01 (6/14/17). As we all know by now, effective for tax years beginning after December 31, 2017, the old TEFRA partnership audit rules (in §§ 6221-6231) and Electing Large Partnership rules (in §§ 6240-6242, 6245-6248, 6251-6252, and 6255) have been repealed and replaced by a new "Centralized Partnership Audit Regime" contained in §§ 6221-6223, 6225-6227, 6231-6235, and 6241. The IRS originally released proposed regulations under the new regime in January 2017, but the Trump administration's regulatory freeze forced those regulations to be withdrawn just two days after they were released. The Treasury Department has now reissued the proposed regulations in substantially the same form as the version released in January. Only two minor changes were made from the original version of the proposed regulations issued in January: (i) an example with respect to netting ordinary income and depreciation was deleted (see the January version of Prop. Reg. § 301.6225-1(f) Ex. 3), and (ii) the portion of the regulations seeking comments concerning tiered partnership "push-out" adjustments (discussed below) was expanded. The scope and complexity of the new "Centralized Partnership Audit Regime" preclude in-depth coverage here, but the highpoints are summarized below.

The Practical Effect. Virtually all partnership agreements (including, of course, most LLC operating agreements) should be amended to reflect the new Centralized Partnership Audit Regime. The new regime cannot be ignored because it fundamentally alters the obligations of the partnership and the partners to each other and to the IRS.

Overview. The new rules implement an entity-level audit process that allows the IRS to assess and collect the taxes from the partnership unless the partnership properly elects out of the regime or properly "pushes out" the tax liability to its partners. Under the new centralized process, the IRS audits the partnership's items of income, gain, loss, deduction, and credit, and the partners' distributive shares thereof, for a partnership's taxable year (the "reviewed year"). Then, the IRS sends the partnership a "notice of proposed partnership adjustment" ("NOPPA"). *See* § 6221; Prop. Reg. § 301.6221(a)-1. Thereafter, the partnership has a 330-day period (subject to agreed-upon extensions) to respond to the IRS's proposed adjustments, including the ability to request modifications (discussed below) to any proposed tax liability imposed upon the partnership. Next, at the conclusion of the audit process the IRS sends a "final notice of partnership adjustment" ("FPA") to the partnership (the "adjustment year"). Absent filing a petition in the Tax Court, the tax liability (including penalties) of the partners relating to the reviewed year must be satisfied by the partnership in the adjustment year. *See* § 6231; Prop. Reg. § 301.6231-1. The partnership, not the partners, is liable for any finally determined underpayment of tax (an "imputed underpayment" as defined by the regulations) by the partners from the reviewed year even if those partners are not the same as the partners in the adjustment year. *See* § 6225(a)-(b); Prop. Reg. 301.6225-1.

Modifications to Partnership Level Adjustment. Modifications to a proposed partnership-level adjustment can be asserted by the partnership based upon mitigating factors (e.g., tax-exempt partners, amended returns filed by partners from the reviewed year, lower tax rates applied to some partners, etc.). To assert such modifications, the partnership must submit a "request for modification with respect to a partnership adjustment" to the IRS within 270 days (subject to consensual extension) of the date of the NOPPA. *See* § 6225(c); Prop. Reg. § 301.6225-2. The purpose of allowing partnership-asserted modifications is to determine as accurately as possible the amount of tax owed by the partners as a result of the partnership-level adjustment without requiring the IRS to assess and collect the tax separately from each partner (as was the case under TEFRA). Accordingly, as compared to TEFRA, the new regime substantially eases the IRS's administrative burden with respect to partnership audits and collection of taxes, but correspondingly increases the administrative burden imposed upon partnerships and their partners. Expect the audit rate of partnerships to increase under the new regime.

"Push-Out" Election. As an alternative to assessment and collection of tax from the partnership, the partnership may elect to "push out" the imputed underpayment to the appropriate partners from the reviewed year. The affected partners then become liable for the tax attributable to the imputed underpayment rather than the partnership itself. The push-out election must be made by the partnership representative within 45 days (not subject to extension) of the mailing of the final partnership adjustment ("FPA") under § 6231. *See* § 6226; Prop. Reg. § 301.6226-1.

Some Finer Points. Special rules govern the treatment of adjustments from a reviewed year that do not result in an imputed underpayment and are therefore otherwise taken into account by the partnership and the partners in the adjustment year. *See* Prop. Reg. § 301.6225-3. Moreover, the impact of the adjustments on capital accounts and outside basis across reviewed years and adjustment years is reserved under the proposed regulations. See Prop. Reg. § 301.6225-4. The new regime also imposes tougher rules on partners who treat items inconsistently with the partnership's treatment of such items. *See* § 6222; Reg. § 301.6222-1.

Partnership Representatives. Unlike the familiar "tax matters partner" designation under TEFRA, the new regime permits any person (even a non-partner) with a substantial presence in the U.S. to be designated the "partnership representative" in the audit, assessment, and collection process. The partnership representative is designated by the partnership for each tax year on its annual information return (Form 1065). Moreover, any action taken by the partnership representative vis-à-vis the IRS is binding upon the partnership regardless of the partnership agreement or state law to the contrary. See § 6223; Prop. Reg. §§ 301.6223-1, 301.6223-2.

Election Out of the New Regime for Small Partnerships. Partnerships with 100 or fewer partners may elect out of the new regime, but not if the partnership has another partnership or certain other flow-through entities as a partner, possibly including single-member LLCs (the effect of which currently is unknown under the proposed regulations). Depending upon certain special rules, S corporations may or may not disqualify a partnership from electing out of the new regime. *See* § 6621(b); Prop. Reg. § 301.6621(b)-1. Eligible partnerships that elect out of the new regime will subject their partners to pre-TEFRA audit procedures (i.e., partners will be audited and assessed separately and possibly inconsistently).

Pre-2018 Election Into the New Regime. The reissued proposed regulations do not affect the ability of partnerships to elect into the new regime for tax years beginning before January 1, 2018, but after November 2, 2015. See T.D. 9780, Election into the Partnership Audit Regime Under the Bipartisan Budget Act of 2015, 81 F.R. 51795 (8/5/16).

c. Treasury has issued final regulations on electing out of the new partnership audit regime. T.D. 9829, Election Out of the Centralized Partnership Audit Regime, 83 F.R. 4 (1/2/18). The Treasury Department and the IRS have finalized, with some changes, the portion of the proposed regulations that address electing out of the new Centralized Partnership Audit Regime (REG-136118-15, Centralized Partnership Audit Regime, 82 F.R. 27334-01 (6/14/17).) Like the proposed regulations, final Reg. § 301.6221(b)-1 provides that a partnership with 100 or fewer partners that does not have certain kinds of partners can make an election not to be subject to the new regime on the partnership's timely filed return, including extensions, for the taxable year to which the election applies. To constitute a valid election, the elction must include all information required by the IRS in forms, instructions, or other guidance. This final regulation applies to partnership taxable years beginning after December 31, 2017.

G. Miscellaneous

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

B. Charitable Giving

1. Taxpayers have a greater ability to deduct charitable contributions for relief efforts in areas affected by Hurricanes Harvey, Irma, or Maria. The Disaster Relief and Airport and Airway Extension Act of 2017 ("2017 Disaster Relief Act"), Pub. L. No. 115-63, was signed by the President on September 29, 2017. Section 504(a) of the 2017 Disaster Relief Act provides special rules for charitable contributions for the benefit of victims of Hurricanes Harvey, Irma, or Maria. Normally, the limit that applies to the deduction for most charitable contributions by individuals is 50 percent of the taxpayer's contribution base, which, generally speaking, is adjusted gross income. Lower limits can apply depending on the type of recipient and the type of property contributed. The limit that applies to the deduction for most charitable contributions by corporations generally is 10 percent of taxable income. Contributions that exceed these limits generally can be carried forward five years. The legislation provides that "qualified contributions" by an individual are not subject to the normal limits, and instead are allowed up to the amount by which the taxpayer's contribution base (AGI) exceeds the other charitable contributions the taxpayer makes, i.e., those subject to the normal limit. In effect, this permits individual taxpayers to deduct qualified contributions up to 100 percent of the taxpayer's contribution base (AGI) after taking into account other charitable contributions. Further, qualified contributions are not subject to the normal overall limit on itemized deductions of § 68. For corporations, the limit on qualified contributions is the amount by which the corporation's taxable income exceeds the corporation's other charitable contributions, i.e., the corporation can deduct qualified contributions up to 100 percent of taxable income after taking into account other charitable contributions. Qualified contributions by an individual or a corporation that that exceed the relevant limit can be carried forward five years. A *qualified contribution* is defined as a charitable contribution (as defined in § 170(c)) that meets three requirements: (1) the contribution must be paid in cash to an organization described in § 170(b)(1)(A) during the period from August 23 through December 31, 2017, for relief efforts in the Hurricane Harvey disaster area, Hurricane Irma disaster area, or Hurricane Maria disaster area, (2) the taxpayer must obtain from the organization a contemporaneous written acknowledgment that the contribution was used (or will be used) for such relief efforts, and (3) the taxpayer must elect the application of this special rule. For partnerships or S corporations, the election is made separately by each partner or shareholder. The legislation does not specify the manner of making the election. Presumably, taking the deduction on the return will constitute an election.

a. Congress has enacted a similar increase in the limit on deductions for charitable contributions towards relief efforts in areas affected by California wildfires. The

Bipartisan Budget Act of 2018, § 20104(a) of Division B, provides that "qualified contributions" by an individual are not subject to (1) the normal limits on charitable contributions, and instead are allowed up to 100 percent of the taxpayer's contribution base (AGI) after taking into account other charitable contributions, and (2) are not subject to the normal overall limit on itemized deductions of § 68. For corporations, the limit on qualified contributions is 100 percent of taxable income after taking into account other charitable contributions. Qualified contributions by an individual or a corporation that that exceed the relevant limit can be carried forward five years. A *qualified contribution* is defined as a charitable contribution (as defined in § 170(c)) that meets three requirements: (1) the contribution must be paid *in cash* to an organization described in § 170(b)(1)(A) during the period from October 8, 2017, through December 31, 2018, for relief efforts in the California wildfire disaster area, (2) the taxpayer must obtain from the organization a contemporaneous written acknowledgment that the contribution was used (or will be used) for such relief efforts, and (3) the taxpayer must elect the application of this special rule. For partnerships or S corporations, the election is made separately by each partner or shareholder.

- This provision may have little effect for most individuals for two reasons. First, beginning in 2018, many more individuals will take the increased standard deduction enacted as part of the 2017 Tax Cuts and Jobs Act and will not itemize their deductions on Schedule A of Form 1040. Second, pursuant to the 2017 Tax Cuts and Jobs Act, the § 68 overall limit on itemized deductions does not apply to taxable years beginning after 2017 and before 2026.

X. TAX PROCEDURE

A. Interest, Penalties and Prosecutions

B. Discovery: Summons and FOIA

C. Litigation Costs

D. StatutoryNotice of Deficiency

E. Statute of Limitations

F. Liens and Collections

1. **If the IRS wrongfully levies on assets in a retirement account, the taxpayer can recontribute the assets pus interest in a tax-free rollover.** The Bipartisan Budget Act of 2018, § 41104, amended Code § 6343 by adding § 6343(f). Section 6343(f) provides that, if the IRS determines that an individual's account or benefit under an eligible retirement plan (as defined in § 402(c)(8)(B)) was levied upon wrongfully or otherwise not in accordance with administrative procedures and property or an amount of money is to be returned to the individual, then the individual can contribute the money (plus any interest paid by the IRS) or property into the same retirement plan (if permitted by the plan) or another eligible plan or IRA without regard to the normal limits on contributions or rollovers. When this provision applies, the distribution resulting from the levy and the subsequent contribution are treated as a tax-free rollover. The contribution is treated as having been made for the same taxable year in which the distribution resulting from the levy occurred. Any interest paid by the IRS is treated as earnings within the plan after the contribution and is not included in the taxpayer's gross income. The rollover does not count towards the one-rollover-per- twelve- months limitation of § 408(d)(3)(B). A taxpayer who already included the amount of the distribution in gross income in an earlier year and has had tax assessed is entitled to have the assessment abated and to obtain a refund of any tax paid. The provision applies to amounts paid by the IRS in taxable years beginning after 2017.

2. **The fees for installment agreements are going up!** T.D. 9798, User Fees for Installment Agreements, 81 F.R. 86955 (12/2/16). The Treasury Department and the IRS have finalized without change proposed regulations (REG-108792-16, User Fees for Installment Agreements, 81 F.R. 56543 (8/22/16)) that significantly increase the user fees for entering into an installment agreement. Prior to the effective date of these regulations: (1) the general user fee for an installment agreement is $120, which is reduced to $52 for a direct debit installment agreement that permits the IRS to withdraw the installment payments from the taxpayer's bank account; (2) the user fee is $43 for a low income taxpayer, defined as a taxpayer who has income at or below 250 percent

of the federal poverty guidelines; and (3) the fee for restructuring or reinstating an installment agreement is $50. Under the final regulations, the fee for low income taxpayers remains the same, but the general fee increases to $225, the direct debit fee increases to $107, and the fee for restructuring or reinstating an installment agreement increases to $89. In addition, the regulations establish two new user fees for online payment agreements. The general user fee for a taxpayer who sets up an installment agreement online is $149, and the fee for a direct debit online payment agreement is $31. These regulations apply to installment agreements entered into, restructured, or reinstated on or after January 1, 2017.

a. Low-income taxpayers can pay no fee for installment agreements, and the user fees for installment agreements for other taxpayers will never go up again. Wait, really? The Bipartisan Budget Act of 2018, § 41105, amended Code § 6159 by redesignating subsection (f) as subsection (g) and adding new subsection (f). New § 6159(f) provides that any fee imposed by the IRS for entering into an installment agreement cannot exceed the fee in effect on February 9, 2018, the date of enactment of the legislation. Section 6159(f) as amended also provides that a taxpayer whose adjusted gross income does not exceed 250 percent of the federal poverty guidelines will either (1) pay no fee for a direct debit installment agreement that permits the IRS to withdraw the installment payments from the taxpayer's bank account, or (2) pay the applicable fee up front if the agreement does not provide for direct debit and then obtain a refund of the fee upon completion of the installment agreement. This provision applies to installment agreements entered into on or after the date which is 60 days after the date of the enactment. Because the date of enactment is February 9, 2018, the provision should apply to agreements entered into on or after April 10, 2018.

G. Innocent Spouse

H. Miscellaneous

1. What does "separate return" mean? Ibrahim v. Commissioner, 788 F.3d 834 (8th Cir. 6/10/15), *rev'g* T.C. Memo. 2014-8. The taxpayer and his wife originally filed separate tax returns. He claimed head of household filing status on his return, and his wife claimed single filing status on her return. The IRS sent a timely notice of deficiency to the taxpayer; he filed a Tax Court petition to challenge the deficiency. The taxpayer and his wife did not elect to file an amended joint return before receipt of the notice of deficiency. The taxpayer argued that he was entitled to amend his return to elect married filing jointly filing status. Section 6013(b)(2)(B) specifically bars taxpayers from electing to file a joint return after filing separate returns "after there has been mailed to either spouse, with respect to such taxable year, a notice of deficiency under section 6212, if the spouse, as to such notice, files a petition with the Tax Court within the time prescribed in section 6213." The Tax Court (Judge Nega) held that § 6013(b)(2) applies to married taxpayers who file returns with an incorrect status, such as head of household or single filing status. Thus, according to the Tax Court, the taxpayer was ineligible to elect to amend his return to file jointly with his spouse, and the deficiency was upheld. The Tax Court rejected the taxpayer's argument that it should follow *Glaze v. United States*, 641 F.2d 339 (5th Cir.1981), which held that "separate return" as used in § 6013(b) refers only to married filing separately status and not to any other filing status, including head of household. Prior Tax Court precedent was cited as controlling because the case was appealable to the Eighth Circuit, which had not addressed the issue.

- The U.S. Court of Appeals for the Eighth Circuit saw it differently and reversed (2-1) in an opinion by Judge Benton. After analyzing the context in which the term "separate return" appears in numerous Code sections, the court concluded that the term applies only to a "married filing separately" return. A head of household return, the court held, is not a "separate return" for purposes of § 6013(b). The majority rejected the IRS's reliance on Rev. Rul. 83-183, 1983-2 C.B. 220, which ruled that taxpayers may not file joint returns more than three years after the due date of the return if one of the spouses has filed a return claiming any of the following filing statuses: unmarried, head of household, or married filing separately. Thus, according to the court, the taxpayer could file an amended joint return, even after receipt of the notice of deficiency, when he had erroneously filed with head of household filing status and his wife had erroneously filed with single filing status.

- Judge Bye dissented and would have held that for purposes of

§ 6013 any non-joint returns, including head-of-household returns, should be treated as separate returns.

a. The Tax Court now agrees with the Eighth Circuit. Camara v. Commissioner, 149 T.C. No. 13 (9/28/17). The taxpayer and his wife were married at all relevant times. The taxpayer filed a return for 2012 and erroneously indicated on the return that his filing status was single. His wife did not file a return for 2012. The IRS issued to the taxpayer a notice of deficiency that changed his filing status to married filing separately. The taxpayer and his wife challenged the notice of deficiency by filing a petition in the Tax Court. On May 27, 2016, approximately one year after filing the petition, the taxpayer and his wife filed a joint return for 2012. The IRS asserted that the taxpayers were precluded from filing a joint return by § 6013(b). Section 6013(b)(1) provides that "if an individual has filed a separate return for a taxable year for which a joint return could have been made by him and his spouse," the individual and his or her spouse can nevertheless file a joint return. However, § 6013(b)(2) provides that "the election" authorized by § 6013(b)(1) cannot be made in certain circumstances. According to § 6013(b)(2)(A), the election to file a joint return cannot be made if more than three years have elapsed from the due date of the return (determined without regard to extensions). Section § 6013(b)(2)(B) provides that the election to file jointly cannot be made after the IRS has mailed a notice of deficiency to either spouse if the spouse files with respect to the notice a timely petition with the Tax Court. The IRS asserted that both of these exceptions precluded the taxpayer from filing a joint return. In a unanimous, reviewed opinion by Judge Thornton, the Tax Court reassessed its holding in *Ibrahim v. Commissioner*, T.C. Memo. 2014-8, and other prior decisions and held that the term "separate return" in § 6013(b)(1) "means a return on which a married taxpayer has claimed the permissible filing status of married filing separately, rather than a return on which a married taxpayer has claimed a filing status not properly available to him or her." Because a taxpayer is precluded by § 6013(b)(2) from filing a joint return only if the taxpayer has previously filed a "separate return," and the taxpayer in this case had not filed a separate return, the taxpayer was not barred from electing to file a joint return. In reaching this conclusion, the court relied on the statutory language of § 6013(b)(2), which bars a taxpayer from filing jointly only if the taxpayer has previously made an "election" to file a separate return. The court reasoned that filing a return with an erroneous filing status is not an election for this purpose. The court also relied on its analysis of (1) the historical development of joint filing status and rate structures for those filing jointly, and (2) the legislative history of § 6013(b). The Tax Court thus has aligned itself with the holdings in *Glaze v. United States*, 641 F.2d 339 (5th Cir.1981), and *Ibrahim v. Commissioner*, 788 F.3d 834 (8th Cir. 2015).

2. The IRS has provided extensions of filing and payment due dates for those in areas affected by Hurricanes Harvey, Irma, and Maria. In news release IR-2017-160 (9/26/17), the IRS has summarized the relief announced in a series of prior news releases for those in areas affected by Hurricanes Harvey, Irma, and Maria. The relief is available to individuals and businesses anywhere in Florida, Georgia, Puerto Rico, and the Virgin Islands, as well as parts of Texas. (Parts of Puerto Rico qualify for the Hurricane Irma relief, and all of Puerto Rico qualifies for the Hurricane Maria relief. Hurricane Maria struck Puerto Rico just after September 15, 2017, so in theory there are parts of Puerto Rico that do not qualify for relief from September 15 due dates.) The prior news releases are IR-2017-135 (8/28/17) (relief in Texas for Harvey), VI-2017-01 (9/8/17) (relief in Virgin Islands for Irma), PR-2017-01 (9/12/17) (relief in Puerto Rico for Irma), IR-2017-150 (9/12/17) (relief in Florida for Irma), IR-2017-155 (9/15/17), (expanded relief in Florida for Irma), IR-2017-156 (9/19/17) (expanding Irma relief to all of Georgia).

Deadlines extended to January 31, 2018. For those in affected areas, the following due dates have been extended to January 31, 2018: (1) the September 15, 2017, and January 16, 2018, due dates for quarterly estimated tax payments; (2) the September 15, 2017, due date for certain returns, such as those for calendar-year partnerships that filed timely extension requests for 2016; (3) the October 16, 2017, due date for 2016 individual returns for individuals who filed timely extension requests; (4) the October 31, 2017, due date for quarterly payroll and excise tax returns; and (5) the November 15, 2017, due date for 2016 returns of calendar-year tax-exempt organizations that filed timely extension requests. Note: individuals who filed a timely request for an extension of time to file their 2016 returns do not obtain any relief for tax payments related to the 2016 return because those payments were due on April 18, 2017.

Waiver of late-deposit penalties for federal payroll and excise taxes. For those in affected areas, the IRS has waived late-deposit penalties for federal payroll and excise taxes due during the first fifteen days of the disaster period. The specific dates vary according to the location.

Relief provided automatically. The IRS will automatically provide filing and penalty relief to any taxpayer with an address of record in one of these disaster areas. Taxpayers in one of these areas who receive a notice from the IRS regarding a late-filing or late-payment penalty should contact the IRS at the number listed on the notice to have the penalty abated.

a. The IRS has provided similar extensions of filing and payment due dates for those affected by California wildfires. In news release IR-2017-172 (10/31/17), the IRS has extended to January 31, 2018, several filing and payment due dates that occurred beginning on October 8, 2017, for those in areas affected by California wildfires. The relief is available to individuals and businesses in the counties of Butte, Lake, Mendocino, Napa, Nevada, Sonoma and Yuba, as well as firefighters and relief workers who live elsewhere. The due dates extended include the October 16, 2017, due date for 2016 individual returns for individuals who filed timely extension requests, the October 31, 2017, due date for quarterly payroll and excise tax returns, and the January 16, 2018, due date for quarterly estimated tax payments. The IRS will automatically provide filing and penalty relief to any taxpayer with an address of record in one of these disaster areas. Taxpayers in one of these areas who receive a notice from the IRS regarding a late-filing or late-payment penalty should contact the IRS at the number listed on the notice to have the penalty abated.

b. The IRS has provided extensions of filing and payment due dates for those affected by California wildfires, flooding, mudflows and debris flows. In news release CA-2018-1 (1/17/18), the IRS has extended to April 30, 2018, several filing and payment due dates for those affected by the wildfires, flooding, mudflows and debris flows that took place beginning on Dececember 4, 2017, in parts of California. The relief is available to individuals and businesses in the counties of Los Angeles, San Diego, Santa Barbara, and Ventura. The due dates extended include the January 16, 2018, due date for quarterly estimated tax payments and the April 17, 2018, due date for 2017 individual returns. More generally, taxpayers have until April 30, 2018, to file most tax returns (including individual, corporate, and estate and trust income tax returns; partnership returns, S corporation returns, and trust returns; estate, gift, and generation-skipping transfer tax returns; and employment and certain excise tax returns; annual information returns of tax-exempt organizations; and employment and certain excise tax returns), that have either an original or extended due date occurring on or after December 4, 2017, and before April 30, 2018. The IRS will automatically provide filing and penalty relief to any taxpayer with an address of record in one of these disaster areas. Taxpayers in one of these areas who receive a notice from the IRS regarding a late-filing or late-payment penalty should contact the IRS at the number listed on the notice to have the penalty abated. Affected taxpayers who reside or have a business located outside the covered disaster area must call the IRS disaster hotline at 866-562-5227 to request this tax relief.

3. Trust but verify—taxpayers need to check the amount of taxes being withheld from their paychecks. The IRS has issued revised withholding tables that take into account changes made by the 2017 Tax Cuts and Jobs Act. Notice 1036 (1/11/18) and IRS News Release IR-2018-05 (1/11/18). Among other changes, the 2017 Tax Cuts and Jobs Act reduced tax rates, significantly increased the standard deduction, and eliminated personal exemption deductions. The overall effect of the legislation is to reduce the amount of tax owed by most taxpayers. In light of these changes, the IRS has issued new withholding tables for use by employers. The new withholding tables generally direct employers to withhold less in taxes from the paychecks of employees compared to the former tables. The IRS has directed employers to begin using the new tables as soon as possible, but no later than February 15, 2018. The new withholding tables are designed not to require employees to file a new Form W-4 with their employers.

a. The IRS has updated its online withholding calculator and issued a revised Form W-4. IRS News Release IR-2018-36 (2/28/18). The IRS has released an updated withholding calculator on its website to help taxpayers check their 2018 withholding in light of the changes made by the 2017 Tax Cuts and Jobs Act. Simultaneously, the IRS issued a revised Form W-

4 that eliminates references to dependents and reflects certain other changes enacted by the legislation.

4. Seniors now will benefit not only from the early-bird special, but also from a simplified return on Form 1040SR. The Bipartisan Budget Act of 2018, § 41106, directs the Secretary of the Treasury to make available an individual federal income tax return, to be known as "Form 1040SR," for use by individuals who have attained age 65 by the close of the taxable year. Form 1040SR is to be as similar as practicable to Form 1040EZ, except that it will be available regardless of the taxpayer's level of income and regardless of whether the taxpayer's income includes social security benefits, distributions from qualified retirement plans or annuities, interest and dividends, or capital gains and losses taken into account in determining adjusted net capital gain. Congress has directed that Form 1040SR be available for taxable years beginning after February 9, 2018, the date of enactment.

XI. WITHHOLDING AND EXCISE TAXES

A. Employment Taxes

B. Self-employment Taxes

1. ♪♫Ain't no closing time, ain't no cover charge. Just country boys and girls getting down on the farm.♫♪ And now there ain't no self-employment tax from renting agricultural land to your wholly owned S corporation (at least if it's a fair market rent). Martin v. Commissioner, 149 T.C. No. 12 (9/27/17). The taxpayers, a married couple, owned a farm in Texas consisting of more than 300 acres. They entered into an agreement with Sanderson Farms, Inc., a large poultry producer, to raise and deliver young chickens designated as broilers. The contract, known as the Broiler Production Agreement (BPA), contained extensive requirements with which the taxpayers had to comply. To enable their performance under the BPA, the taxpayers constructed facilities on the farm at a cost of $1.2 million. Subsequently, the taxpayers formed a wholly-owned S corporation and entered into oral employment agreements with it. They set their salaries at amounts consistent with those of other growers based on information they had gathered. They assigned the BPA to their S corporation. They also entered into a five-year lease with the S corporation pursuant to which the S corporation paid them a total of $1.3 million to rent their farm (excluding their residence and ten acres). The rent was a fair market rent and was consistent with amounts that Sanderson Farms paid other growers for the use of similar premises. During 2008 and 2009, the S corporation paid rent to the taxpayers of $259,000 and $271,000, respectively. The IRS asserted that these amounts were net earnings from self-employment and therefore subject to self-employment tax. In a reviewed opinion (12-0-4) by Judge Paris, the Tax Court held that the rental payments were not subject to self-employment tax. In reaching this conclusion, the court reconsidered and declined to follow its analysis of this issue in *McNamara v. Comissioner*, T.C. Memo. 1999-333, and instead adopted the approach of the U.S. Court of Appeals for the Eighth Circuit, which reversed the Tax Court's decision in *McNamara*. *See McNamara v. Commissioner*, 236 F.3d 410 (8th Cir. 2000). Under § 1402(a)(1), rentals from real estate are excluded from net earnings from self-employment, but this exclusion does not apply to income derived by an owner or tenant of land if

> (A) such income is derived under an arrangement, between the owner or tenant and another individual, which provides that such other individual shall produce agricultural or horticultural commodities … on such land and that there shall be material participation by the owner or tenant … in the production or management of the production of such … commodities, and
>
> (B) there is material participation by the owner or tenant … with respect to such agricultural or horticultural commodity.

The court rejected the IRS's argument that the rental payments received by the taxpayers fell into this exception. The IRS argued that there existed an arrangement between the taxpayers and both their S corporation and Sanderson Farms that required the taxpayers to materially participate in the production of agricultural commodities (the broilers). The court reasoned, however, that in its prior opinion in *McNamara*, it had not given sufficient consideration to the statute's requirement that the rent be "*derived under*" an arrangement requiring the owner's material participation, i.e., that there be a nexus between the rent received and the owner's material participation. If the rental agreement stands on its own, then the required nexus necessarily does not exist. Consistent with the Eighth Circuit's analysis, the court reasoned that market-rate rents strongly suggest that the rental agreement stands on its own and is not part of an arrangement requiring material participation. Accordingly, the court held as follows:

> Irrespective of a taxpayer's material participation—actual, required, or otherwise—the taxpayer may establish that the rental agreement stands on its own, unrelated to the taxpayer's farming activity. … If the rental income received was at or below market value, the burden of production then shifts to the Commissioner to show a nexus between the rent and the agricultural arrangement requiring the taxpayer to materially participate.

In this case, the court found, the rental income received by the taxpayers was at or below fair market value. Therefore, the burden of production shifted to the IRS to demonstrate a nexus between the rent and the arrangement requiring the taxpayers' material participation. The IRS, however, did not brief this issue and instead relied upon the Tax Court's prior analysis in *McNamara*, which interpreted the term "arrangement" broadly.

- Judge Gustafson, in a dissent joined by Judge Ashford, reasoned that, although a fair market rent may be evidence that a rental agreement stands on its own and is not part of an arrangement requiring material participation, there is no basis for the evidentiary regime set forth in the majority opinion. "There is no reason to select the reasonableness of the rent as a special fact that somehow gives rise to a presumption and shifts the burden of production.

- Judge Nega's dissent, in which Judges Ashford, Gustafson, and Lauber joined, concluded that the approach of the U.S. Court of Appeals for the Eighth Circuit in *McNamara*, which the majority opinion adopted, is inconsistent with the plain language of § 1402(a)(1). The statute, he stated, does not provide a special rule for rents that are at or below a fair market rent. "A better reading of section 1402(a)(1), including the words 'derived under', is that the arrangement as a whole must be the focus instead of what the parties define as falling within two or more income streams (in this case payments for personal services and for the use of real estate and personal property)." Judge Nega expressed concern that the majority's approach will give rise to situations in which "the existence of a tax-indifferent party leads to an agreement between two parties to mischaracterize a transaction to provide an unjustified tax result for the non-tax-indifferent party."

C. Excise Taxes

XII. TAX LEGISLATION

A. Enacted

1. Congress has retroactively extended a number of provisions designed to act as taxpayer incentives and made other changes. Wait, retroactive incentives? The Bipartisan Budget Act of 2018, Pub. L. No. 115-123, was signed by the President on February 9, 2018. This legislation retroactively extends a number of provisions through 2017, such as § 163(h)(3)(E)'s treatment of mortgage insurance premiums as deductible mortgage interest, the § 222 above-the-line deduction for qualified tuition and related expenses, the § 108(a)(1)(E) exclusion for cancellation of qualified principal residence indebtedness, favorable recovery periods for certain depreciable property, and various credits related to energy efficiency. The legislation also makes certain other changes to the Internal Revenue Code, such as a provision that precludes any increase in the current user fees for installment agreements.

XIII. TRUSTS, ESTATES & GIFTS