Small Business/Self Employed

SB/SE Examination Tax Cuts and Jobs Act

Student Guide

ELMS Course Number 73223

Official IRS Training Material

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IDRS SECURITY

Integrated Data Retrieval System (IDRS) users are authorized to access only taxpayer information (accounts) to carry out their official tax administration duties. Employees, to include IDRS users, are not authorized to initiate an access to their own records or records of their spouse and any ex-spouse; their children; their parents; anyone living in their household; their other close relatives, friends or neighbors with whom they have close relationships; celebrities when the information is not needed to carry out tax-related duties; an individual or organization for which they or their spouse is an officer, trustee, general partner, agent, attorney, consultant, contractor, employee, or member; and any other individual or organization with whom they may have a personal or outside business relationship that could raise questions about their impartiality in handling the tax matter.

When employees are working assigned cases or contacts, they can access other IRS employees' tax records. However, when the employee working the case knows the other employee, the case must be referred to management for reassignment. If in doubt, at any time, employees need to ask their managers whether an access is authorized.

Additional information regarding unauthorized access can be found in *Safeguarding Taxpayer Records Renewing Our Commitment – UNAX Employee Booklet* (Document 10281, rev. 09-2013).

Notices and Disclaimers

Identification Numbers

Any employee numbers, computer ID numbers, Social Security numbers (SSNs) and any other identification used in this course are hypothetical. They were constructed by random selection of numbers to appear realistic and increase the effectiveness of the training. Any duplication of numbers actually assigned is purely coincidental. All other names and numbers used in this material are fictitious.

Naming Conventions

Any taxpayer, employee and business names shown in this publication are fictitious. They were chosen at random from a list of names from categories of objects, such as fish, birds, minerals, etc. Street addresses were chosen from this same list and are also not meant to identify any actual addresses.

Graphics and Screen Captures

Exhibits of screen captures do not contain any live taxpayer information. All information was sanitized to protect taxpayer information.

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Course 73233 Information

Course Description

On December 22, 2017, The Tax Cuts and Jobs Act was signed into law. This legislation contained 119 provisions of which 28 which were assigned to SBSE Examination. This self-study module contains information on 17 provisions to assist you with gaining an understating of the tax law changes implemented and identifying potential issues.

Target Audience

This course is designed for Servicewide employees.

e-Book

The materials for this course were created using an e-book format. The materials are to be used electronically. It is recommended that you save the e-book to your desktop for easy access.

Find job aids for using Adobe Acrobat PDF documents as an e-book on the IRS publishing catalog:

- #55364, Using Adobe e-Books – for Students

Course Schedule

Provision#	Provision Title	Time
11024	Increased Contributions to ABLE Accounts	15 minutes
11025	Rollovers to ABLE Programs from 529 Programs	15 minutes
11047	Suspension of Exclusion for Qualified Bicycle Commuting Reimbursement	15 minutes
11048	Suspension of Exclusion for Qualified Moving Expense Reimbursement	15 minutes
11061	Increase in Estate and Gift Tax Exemption	15 minutes
12001	Repeal of Corp Alt Min Tax	15 minutes
12002	Credit for Prior Year Min Tax Liability of Corp	15 minutes
13303	Like-Kind Exchanges of Real Property	15 minutes
13307	Denial of Deduction for Settlements Subject to Nondisclosure Agreements – Sexual Harassment/Abuse	15 minutes
13310	Prohibition on Cash, Gift Cards, and Other Non-Tangible Personal Property as Employee Achievement Awards	15 minutes
13402	Rehabilitation Credit Limited to Certified Historic Structures	15 minutes
13403	Employer Credit For Paid Family and Medical Leave	15 minutes
13541	Expansion of Qualifying Beneficiary – Electing Small Business Trust	15 minutes
13542	Charitable Contributions – Electing Small Business Trust	15 minutes
13543	Modification of Treatment of S Corporations Conversion to C Corporations	15 minutes
13821	Modification of Tax Treatment of Alaska Native Corp and Settlement Trusts	15 minutes
13822	Amounts Paid for Aircraft Management Services	15 minutes
	Total Time	**4 hours 15 minutes**

Training Methods

This is a self-study module

Evaluation Plan

It is important to gather feedback to evaluate the effectiveness of the training course.

Level 1

Target audience: All students

Purpose: The Level 1 Evaluation is to:

- Measure the reactions to the training materials and the training environment.
- Identify errors in the written course materials.
- Make suggestions on improving the course design.

Students: Each student will have an opportunity to complete a Level 1 Evaluation.

- ELMS will send a system-generated email notification with a link to the Level 1 survey.
- Completion of the survey is optional but encouraged.

Tax Cuts and Jobs Act

Provisions 11024 and 11025

ABLE Accounts

Overview

Introduction

An Achieving a Better Life Experience (ABLE) account is a tax-favored savings account that can accept contributions for an eligible blind or disabled individual who is the designated beneficiary and owner of the account. States can offer ABLE accounts to help people who become disabled before age 26, and their families, save and pay for disability-related expenses. These expenses include, but are not limited to, housing, education, transportation, health, prevention and wellness, employment training and support, assistive technology and personal support services.

Contributions to an ABLE account are not tax deductible. Although a designated beneficiary may have only one ABLE account, contributions can be made to the ABLE account by anyone including the designated beneficiary. The earnings in an ABLE account aren't taxed unless a distribution exceeds the designated beneficiary's qualified disability expenses. A portion of the earnings of a distribution in excess of the beneficiary's qualified disability expenses is included in income and subject to an additional 10 percent tax.

Provisions 11024 and 11025 of the Tax Cuts and Jobs Act (TCJA) enables some eligible individuals with disabilities to put more money into their ABLE accounts, qualify for the Saver's Credit, and roll money from their 529 plans into their ABLE accounts.

Objectives

At the end of this lesson, you will be able to identify:

- The contribution limit of an ABLE account
- Eligibility requirements for claiming the Saver's Credit for contributions to an ABLE account
- When amounts can be rolled over from a 529 plan to an ABLE account

Contents

Annual Contribution Limit

Prior to enactment of the TCJA provision 11024, the annual contribution limit was tied exclusively to the gift tax exclusion amount, which for 2018 is $15,000. Starting in 2018, if the beneficiary works, the beneficiary can also contribute part or all of what they make to their ABLE account.

This additional contribution is limited to the poverty line amount for a one-person household. For 2018, this amount is $12,140 in the continental U.S., $13,960 in Hawaii, and $15,180 in Alaska. However, the designated beneficiary is not eligible to make this additional contribution if he or she is an employee with respect to whom a contribution is made to a plan described in IRC section 529A(b)(7)(A).

Contributions more than the annual limit must be returned or may be subject to a 6 percent excise tax.

Exercise 1

Pat, a disabled adult living in the continental U.S., receives contributions to an ABLE account from friends and family in the following amounts during 2018:

Father	$2,050
Mother	$3,050
Siblings	$1,500
Friends	$ 600
Grandparents	$7,000

Pat earned $8,650 from a job in a local store and is an employee with respect to whom no contributions are made to a plan described in IRC section 529A(b)(7)(A).

What is the total amount that can be contributed to Pat's ABLE account in 2018?

Answer:

Saver's Credit

Provision 11024 expands the Saver's Credit to include some contributions to ABLE accounts. Starting in 2018, ABLE account beneficiaries may qualify for the Saver's Credit for a percentage of the contributions they make to their ABLE accounts. Up to $2,000 of these contributions qualify for this special credit designed to help low- and moderate-income workers.

Beneficiaries are eligible for the credit if they:

- Are at least 18 years old at the close of the taxable year
- Are not a dependent or a full-time student
- Meet the income requirements

Exercise 2

Jill, a full-time student, works part time at a local retail store. Jill earned $5,000 in 2018 and deposited all earnings into her own ABLE account. Jill is an employee with respect to whom no contribution is made to a plan described in IRC section 529A(b)(7)(A). Is Jill eligible for the Saver's Credit?

Yes | No

Rollovers and Transfers from Section 529 Plans

Provision 11025 allows rollovers and transfers between ABLE accounts of eligible family members. Family members are defined in IRC 152(d)(2)(B) as brothers, sisters, stepbrothers, and stepsisters.

After December 22, 2017, rollovers may be made without penalty from a section 529 plan, also known as a Qualified Tuition Program (QTP) account, to an ABLE account, if the beneficiary of the ABLE account is the designated beneficiary of the QTP account or an eligible family member. An eligible family member for purposes of the QTP to ABLE account transfer is much broader than defined for the ABLE to ABLE account transfers. Eligible family members for QTP to ABLE account transfers include the spouse or first cousin of the beneficiary and any individual or spouse of the individual who has a relationship to the beneficiary as described in IRC 152(d)(2)(A) through (G).

Rollovers and transfers from a section 529 plan count toward the ABLE Account's annual contribution limit.

Exercise 3

During 2018, $10,000 was distributed to Tom as the designated beneficiary of a QTP. He used $8,475 for college expenses. The remainder, $1,525, was rolled over to his spouse's ABLE account and was the only ABLE account contribution in 2018. Tom's spouse suffers from a disability. Is any portion of the $1,525 rollover taxable to Tom?

Yes No

Summary

The TCJA:

- Provision 11024 increased the contribution limit for some working beneficiaries to the lesser of earned income or the poverty limit.
- Provision 11024 extended the eligibility for the Saver's Credit to qualified beneficiaries who make contributions to their own ABLE account.
- Provision 11025 allowed for rollovers and transfers from a QTP account to an ABLE account in some circumstances.

Answers to Exercises

Exercise 1

Answer: $22,850

The total contribution from others is $14,200 and less than the 2018 annual contribution limit of $15,000. Pat earned $8,650 which is below the 2018 poverty limit of $12,140 in the continental U.S. Therefore, the total amount that can be contributed to Pat's ABLE account is $14,200 plus earnings of $8,650 for a total of $22,850.

Exercise 2

☐ Yes ☑ **No**

Jill is not eligible for the Saver's Credit because she is a full-time student.

Exercise 3

☐ Yes ☑ **No**

Tom used a portion of the distribution for his own college expenses and rolled over the remainder to an eligible family member's ABLE account, therefore, no portion of the distribution is taxable to Tom.

Tax Cuts and Jobs Act

Provision 11047

Bicycle Commuting

Overview

Introduction

IRC 132(a) provides that gross income shall not include any fringe benefit that qualifies as one of the following:

1. No-additional-cost service
2. Qualified employee discount
3. Working condition fringe
4. De minimis fringe
5. Qualified transportation fringe
6. Qualified moving expense reimbursement
7. Qualified retirement planning services
8. Qualified military base realignment and closure fringe

IRC 132(f) defines the term “qualified transportation fringe” as any of the following provided by an employer to an employee:

A. Transportation in a commuter highway vehicle, if such transportation is in connection with travel between the employee’s residence and place of employment
B. Any transit pass
C. Qualified parking
D. Any qualified bicycle commuting reimbursement

This lesson will discuss the qualified bicycle commuting reimbursement and the changes made in the new tax law.

Objectives

At the end of this lesson, you will be able to identify changes made under Tax Cuts and Jobs Act (TCJA) regarding qualified bicycle commuting reimbursements.

Contents

Prior Tax Law

Qualified Transportation Fringes: This exclusion is defined in IRC 132(f) and applies to the following benefits:

a. A ride in a commuter highway vehicle, under IRC 132(f)(5)(A), meaning any highway vehicle that transports the employee between the employee's home and work place. The vehicle must seat at least 6 adults (excluding the driver) and the expectation must exist that at least 80 percent of the vehicle's mileage will be for transporting employees between home and work. Employees must occupy at least one-half of the seats, not including the driver.

b. A transit pass, under IRC 132(f)(5)(A), meaning any mass transit pass, token, farecard, or voucher entitling a person to ride free or at a reduced rate on a mass transit system or in a vehicle that seats at least 6 adults (excluding the driver).

c. Qualified parking, under IRC 132(f)(5)(C), meaning parking that the employer provides to employees on or near the employer's business premises. It also includes parking on or near the location from which employees commute to work using mass transit, commuter highway vehicles, carpools or any other means, and

d. Qualified bicycle commuting reimbursement, under IRC 132(f)(5)(F), meaning any employer reimbursement during the 15-month period beginning with the first day of such calendar year for reasonable expenses incurred by the employee during such calendar year for the purchase of a bicycle and bicycle improvements, repair, and storage, if such bicycle is regularly used for travel between the employee's residence and place of employment.

A qualified bicycle commuting reimbursement is a reimbursement provided by an employer for any reasonable expenses incurred by the employee during a calendar year for the purchase of a bicycle and bicycle improvements, repair, and storage. An employee is eligible for this reimbursement only for months during which the employee:

- Regularly uses the bicycle for a substantial portion of the travel between his or her residence and place of employment, and
- Does not receive any other form of qualified transportation fringe benefit (that is, transportation in a commuter highway vehicle, transit pass, or qualified parking).

In 2017, qualified bicycle commuting reimbursements of up to $20 per month could be offered as a tax-free benefit (i.e., excludable from an employee's taxable income and excluded from wages for employment tax purposes), for any month in which the employees regularly used a bicycle to travel to a place of employment, and during which the employee did not receive transportation via a commuter highway vehicle, a transit pass, or qualified parking from an employer. See IRC 132(f)(5)(F).

Amounts which are excluded from gross income under IRC 132 are also excluded from Federal Insurance Contributions Act (FICA) taxes (both social security and Medicare) and Federal income tax withholding. IRC 3121(a)(20) and IRC 3401(a)(19).

New Tax Provision

TCJA Act section 11047 suspends the exclusion from gross income and wages for qualified bicycle commuting reimbursements for taxable years beginning after December 31, 2017, and before January 1, 2026.

Thus, qualified bicycle commuting reimbursements are not excludable from income or wages for any taxable year beginning after December 31, 2017 and before January 1, 2026. However, employers can continue to take income tax deductions for reimbursements provided to employees for bicycle commuting expenses.

The other qualified transportation benefits remain non-taxable.

Audit Considerations

Employers should include any bicycle commuting reimbursements as wage income in the Form W-2 after December 31, 2017.

All non-excludable taxable fringe benefits (including bicycle reimbursements) are includable in box 1 of Form W-2 as wages, tips, and other compensation and, if applicable, in boxes 3 and 5 as social security and Medicare wages (subject to wage limitations).

The following information can be used to identify whether the taxpayer provides any fringe benefits under IRC 132:

Employer and employee interviews: Discussions with the employer and employees may give indications of whether fringe benefits, including bicycle commuting reimbursements, are issues that need to be raised. Additionally, this issue is more common in some industries and locations, notably large metro areas.

Employee Handbooks: Many taxpayers maintain a written employee handbook outlining the benefits available to its employees. Fringe benefits such as bicycle commuting reimbursements are often described in these handbooks.

Employment Contracts: Benefits that are provided on a discriminatory basis may be described in employment contracts with key personnel.

Summary

You are now able to identify changes made under Tax Cuts and Jobs Act (TCJA) regarding qualified bicycle commuting reimbursements.

Tax Cuts and Jobs Act

Provision 11048

Moving Expense Reimbursement

Overview

Introduction

IRC 132(a) provides that gross income shall not include any fringe benefit that qualifies as one of the following:

1. No-additional-cost service
2. Qualified employee discount
3. Working condition fringe
4. De minimis fringe
5. Qualified transportation fringe
6. Qualified moving expense reimbursement
7. Qualified retirement planning services, or
8. Qualified military base realignment and closure fringe

IRC 132(g) defines the term “qualified moving expense reimbursement” as any amount received directly or indirectly by an individual from an employer as payment for expenses which would be deductible as moving expenses under IRC 217 if directly paid or incurred by the individual.

This lesson will discuss the qualified moving expense reimbursement and the changes made in the new tax law.

Objectives

At the end of this lesson, you will be able to identify changes made under Tax Cuts and Jobs Act (TCJA) regarding qualified moving expense reimbursements.

Contents

Prior Tax Law

Qualified Moving Expense Reimbursement: IRC 132(g) applies to any amount given to an employee, directly or indirectly, as payment for, or a reimbursement of, moving expenses. Only those expenses that the employee could deduct under IRC 217, if the employee had paid or incurred them, are excludable.

Expenses that qualify under this exclusion are limited to reasonable expenses for:

- Moving household goods and personal effects from the former home to the new home, and
- Traveling expenses, including lodging, from the former home to the new home.

Amounts which are excluded from gross income under IRC 132 are also excluded from Federal Insurance Contributions Act (FICA) taxes (both social security and Medicare) and Federal income tax withholding. IRC 3121(a)(20) and IRC 3401(a)(19).

Qualified amounts paid by the employer directly to a third-party, such as a moving company, are not reported on Form W-2. Qualified amounts paid directly to the employee by the employer are reported on Form W-2, Box 12, Code P.

Any other non-qualified expenses paid by the employer on behalf of the employee are includible as compensation subject to employment taxes. Examples of nonexcludable expenses include:

- House-hunting trips,
- Storage of goods,
- Closing costs, and
- Interest-free or low-interest loans when an employee's former home has not sold.

New Tax Provision

TCJA Act section 11048 suspends the exclusion from gross income and wages for 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. This applies for taxable years beginning after December 31, 2017, and before January 1, 2026.

Thus, moving expense reimbursements paid after December 31, 2017 and before January 1, 2026 can no longer be excluded from the income and wages of employees who are not active members of the Armed Forces, subject to a limited exception.

Form W-2, Box 12, Code P, is now reserved for reporting non-taxable qualified moving expense reimbursements paid to active-duty members of the U.S. military who move pursuant to a military order and incident to a permanent change of station.

Exception

Notice 2018-75, *Guidance under Section 132(g) for the Exclusion from Income of Qualified Moving Expense Reimbursements*, provides guidance on the application of IRC 132(g)(2) to employer reimbursements in a taxable year beginning after December 31, 2017, for qualified moving expenses incurred in connection with a move that occurred prior to January 1, 2018.

Specifically, this notice provides that the suspension of the exclusion from income provided by IRC 132(a)(6) under IRC 132(g)(2) does not apply to amounts received directly or indirectly by an individual in 2018 from an employer for expenses incurred in connection with a move occurring prior to January 1, 2018, that would have been deductible as moving expenses under IRC 217 if they had been paid directly by the individual prior to January 1, 2018, and that otherwise satisfy the requirements under IRC 132(g)(1). Such amounts will be qualified moving expense reimbursements under IRC 132(g)(1) that are excludable under IRC 132(a)(6).

NOTE: At the date of this publication, the IRS is looking into additional issues raised by recent guidance in Notice 2018-75 on the reimbursement of moving expenses.

Audit Considerations

Employers should be including any moving expense reimbursements as wage income in the Form W-2 for non-active military personnel, subject to the limited exception described in Notice 2018-75 above.

Any non-excludable taxable fringe benefits (including moving reimbursements) are included in box 1 of Form W-2 as wages, tips, and other compensation and, if applicable, in boxes 3 and 5 as social security and Medicare wages (subject to wage limitations).

The following information can be used to identify whether the taxpayer provides any fringe benefits under IRC 132:

- **Employer and employee interviews** – Discussions with the employer and the employees may give indications of whether fringe benefits, including moving expense reimbursements, are issues that need to be raised.
- **Employee Handbooks** – Many taxpayers maintain a written employee handbook outlining the benefits available to their employees. Fringe benefits such as moving reimbursements are often described in these handbooks.
- **Employment Contracts** – Benefits that are provided on a discriminatory basis may be described in employment contracts with key personnel.

Summary

You are now able to identify changes made under Tax Cuts and Jobs Act (TCJA) regarding qualified moving expense reimbursements.

Tax Cuts and Jobs Act

Provision 11061

Increase in Estate and Gift Tax Exclusion

Overview

Introduction

Estate and gift taxes are excise taxes imposed on the transfer of property, either at death (the estate tax) or while the transferor (donor/giver) of the property is still alive (the gift tax). The exclusion determines the total amount that can be transferred during life and at death before any taxes are due.

Under prior law, estate and gift taxes were levied on transfers after applying an exclusion that in 2018 would have been a $5.6 million per decedent exclusion (the $5 million per decedent amount in the statute adjusted annually for inflation).

The Tax Cuts and Jobs Act of 2017 (TCJA) amended I.R.C. section 2010(c)(3) to increase the basic exclusion amount from $5 million, indexed for inflation, to $10 million, indexed for inflation, beginning in 2018. Based on this amendment, in 2019 the basic exclusion amount, adjusted for inflation, is $11,400.000. The tax rate is 40 percent. These changes apply to estates of decedents dying, and to gifts made, after December 31, 2017. The increased basic exclusion amount expires December 31, 2025 and reverts to 2017 amounts (indexed for inflation).

Objectives

At the end of this lesson, you will be able to:

- Explain the major impact of the TCJA on estate and gift taxes
- Understand the types of issues that may be the subject of a referral to Estate and Gift Tax, and typical income tax issues arising from estate and gift tax

Contents

Prior Tax Law

Unified Credit and the Basic Exclusion Amount

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 included several provisions affecting the unified credit and basic exclusion amount:

1. A unified credit is available with respect to taxable transfers by gift and at death. (IRC § 2010) The unified credit offsets tax, which is computed using the applicable estate and gift tax rates, on a specified amount of transfers, referred to as the exclusion amount. The basic exclusion amount was set at $5 million for 2011 and is indexed for inflation for later years.

2. By 2017, the inflation-indexed exclusion amount was $5.49 million. Exclusion used during life to offset taxable gifts reduces the amount of exclusion that remains at death to offset the value of a decedent's estate. An election became available under which exclusion that is not used by a decedent may be used by the decedent's surviving spouse (this is known as "portability").

3. The two taxes were computed using a common tax rate table with a top marginal tax rate of 35 percent.

The American Taxpayer Relief Act of 2012 made the $5 million exclusion (indexed for inflation) and portability permanent as of 2013 at a 40 percent rate.

New Tax Provision

The Tax Cuts and Jobs Act (TCJA), signed December 22, 2017, doubled the basic exclusion amount for gift, estate, and generation-skipping transfer (GST) taxes. (The latter tax (GST) is beyond the scope of this lesson.) The changes found in TCJA are:

- The exclusion amount increased from what would have been $5.6 million per person in 2018, before the law changed, to $11.18 million in 2018. This is the equivalent of $22.36 million total exclusion for married couples. Under TCJA, the exclusion amount continues to be adjusted for inflation.

- The increase in the exclusion amount applies to transfers (whether by gift or at death) from January 1, 2018, through December 31, 2025.
- Portability of a spouse's unused exclusion amount to a surviving spouse was unaffected by TCJA.

Audit Considerations

During income tax examinations, consider referrals to Estate and Gift Tax for the following issues:

- Large transfers of property where the transfer appears to be for less than full and adequate consideration, or promissory notes are given for the transfer. Promissory notes given in exchange for large transfers of property between related parties are of particular interest.
- A deceased taxpayer had, in the years before death, large adjusted gross income, large asset and/or business holdings, and/or large, unexplained decreases in asset and/or business holdings. Keep in mind the applicable year's exclusion amount, as described above, in New Tax Provision.
- The form to make a referral is available on the Estate and Gift Tax page on MySBSE.

Income tax issues arising from estate and gift tax are:

- The basis of gifted property in the hands of the donee generally tracks from the transferor/donor. See IRC § 1015.
- The basis of property acquired from a decedent is generally a stepped-up basis (the fair market value of the property at the date of the decedent's death). See IRC §§ 1014 and 6035.
    - If the taxpayer is disposing of property acquired from a decedent, inquire whether a Schedule A of Form 8971, *Information Regarding Beneficiaries Acquiring Property From a Decedent*, was received from the estate. The form will contain basis information for the property in the hands of the beneficiary.

Summary

Main Points

Under TCJA, beginning in 2018, the exclusion amount for estate and gift taxes increased to $11.18 million, and continues to be adjusted for inflation. For transfers made in 2019, the exclusion amount is $11.4 million. Once the exclusion is used, the tax rate is 40 percent.

Tax Cuts and Jobs Act

Provision 12001

Repeal of Alternative Minimum Tax for Corporations

Overview

Introduction

The Tax Cuts and Jobs Act (TCJA) repealed the Corporate Alternative Minimum (AMT) tax for years beginning December 31, 2017.

Objectives

At the end of this lesson, you will be able to identify key elements of this provision.

References

- IRC section 55 – Repealed for corporate alternative minimum tax
- News release for corporate tax blended rate due to TCJA. Blended Rate Notice IR-2018-99, issued April 16, 2018
- https://www.irs.gov/newsroom/many-corporations-will-pay-a-blended-federal-income-tax-this-year-under-the-new-tax-reform-law

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Prior Law

Under IRC section 55, prior law imposed an alternative minimum tax (AMT) which required corporations to calculate tax under both the regular corporate income tax and the AMT, and determine its tentative minimum tax by limiting or eliminating certain deductions, credits, and other tax preference items. If the corporation's tentative minimum tax amount exceeds its regular tax amount, the excess is the corporation's alternative minimum tax, which it pays in addition to its regular tax.

Practice Exercise 1

You are auditing a corporation with tax year ending December 31, 2017, and on the corporate return the corporation paid alternative minimum income tax of $127,000. The corporation is required to pay alternative minimum income tax. *Check True or False*.

True False

Answer to Exercise

Practice Exercise 1

You are auditing a corporation with tax year ending December 31, 2017, and on the corporate return the corporation paid alternative minimum income tax of $127,000. The corporation is required to pay alternative minimum income tax. *Check True or False*.

☑ **True** ☐ False

The repeal of the Corporate Alternative Minimum (AMT) does not come into effect until after December 31, 2017.

Tax Cuts and Jobs Act

Provision 12002

Credit for Prior Year Minimum Tax Liability of Corporations

Overview

Introduction

IRC section 53 (1) allows the AMT credit to offset the regular tax liability for any taxable year; and (2) provides that the AMT credit is refundable for any taxable year beginning after 2017 and before 2022 in an amount equal to 50 percent (100 percent in the case of taxable years beginning in 2021) of the excess of the minimum tax credit for the taxable year over the amount of the credit allowable for the year against regular tax liability. Effective for taxable years beginning after December 31, 2017.

Objectives

At the end of this lesson, you will be able to identify key elements of this provision.

References

- IRC section 53, *Credit for Prior Year Minimum Tax Liability*
- IRM 21.7.4.4.9.3, *Sequestration of Form 8827 Credit*
- IRM 21.5.9.5.14.8, *Sequestration on the Refundable Amount of the AMT Credit*
- Form 8827, *Credit for Prior Year Minimum Tax – Corporations*

Contents

Prior Law

TCJA eliminated the corporate alternative minimum tax (AMT) under IRC section 55. Before its repeal, a corporate taxpayer that was subject to the AMT was entitled to indefinitely carry forward the AMT taxes paid as minimum tax credits (AMT credit) and utilize the AMT credit against regular tax liabilities in future years.

Practice Exercise 1

A corporation with tax year ending December 31, 2018, claims a credit of 100 percent of the prior year minimum tax liability on their tax return. The corporation is eligible to claim 100 percent of their prior year minimum tax liability. *Check True or False*.

True False

Answer to Exercise

Practice Exercise 1

A corporation with tax year ending December 31, 2018, claims a credit of 100 percent of the prior year minimum tax liability on their tax return. The corporation is eligible to claim 100 percent of their prior year minimum tax liability. *Check True or False*.

☐ True ☑ **False**

A corporation is allowed to claim only 50 percent of the excess of the minimum tax credit for years prior to 2022.

Tax Cuts and Jobs Act

Provision 13303

Like-Kind Exchanges of Real Property

Overview

Introduction

Under the Tax Cuts and Jobs Act of 2017 (TCJA), Section 13303, Like-Kind Exchanges of Real Property, amends IRC § 1031 to apply only to exchanges of real property either held for productive use in a trade or business or for investment. An exchange of real property held primarily for sale does not qualify as a like-kind exchange. Beginning after December 31, 2017, exchanges of personal or intangible property will generally no longer qualify for deferral of gain or loss under IRC § 1031. A transition rule in the new law provides that IRC § 1031 applies to a qualifying exchange of personal or intangible property if the taxpayer disposed of the exchanged property on or before December 31, 2017, or if the taxpayer received replacement property on or before that date.

Objectives

At the end of this lesson, you will be able to:

- Identify changes to IRC § 1031 and effective dates
- Determine eligible like-kind exchange property
- Identify audit considerations to an IRC § 1031 exchange

References

- IRC § 1031
- Treas. Regs. Under § 1031
- IRM 7.25.12.8.1, *Included Income, Excluded Income, and Non-Income Items*

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Identify Changes to IRC § 1031 and Effective Dates

IRC § 1031 provides an exception to the general rule requiring current recognition of gain or loss realized upon the sale or exchange of property. IRC § 1031(a)(1) requires that the property exchanged and the property received be of a like-kind and be property held for productive use in a trade or business or for investment. If, as part of the exchange, other (not like-kind) property is received, realized gain must be recognized to the extent of the lesser of (i) the money and the fair market value of the other property or (ii) the realized gain. IRC § 1031(b). Any realized loss is not recognized. IRC § 1031(c).

Prior Law

Prior to the TCJA, IRC § 1031 applied to exchanges of personal and intangible property as well as real property with the following exceptions:

- Stock in trade or other property held primarily for sale;
- Stocks, bonds, or notes;
- Other securities or evidences of indebtedness or interest;
- Interests in a partnership;
- Certificates of trust or beneficial interests; or
- Chosen in action.

Note: An interest in a partnership which has in effect a valid election under IRC § 761(a) to be excluded from the application of all of subchapter K is treated as an interest in each of the assets of such partnership and not as an interest in a partnership.

The term “stock” did not include certain mutual ditch, reservoir or irrigation stock. IRC § 1031(i).

Current Law

Under the TCJA, IRC § 1031 applies only to exchanges of real property. Section 1031(a). The changes to IRC § 1031 are effective for exchanges beginning after December 31, 2017. An exchange of real property held primarily for sale does not qualify as a like-kind exchange. IRC § 1031(a)(2).

Thus, effective January 1, 2018, exchanges of machinery, equipment, vehicles, artwork, collectibles, patents and other intellectual property and intangible business assets generally do not qualify for non-recognition of gain or loss as like-kind exchanges. However, certain exchanges of mutual ditch, reservoir or irrigation stock are still eligible for non-recognition of gain or loss as like-kind exchanges[1].

Section 13303(c) of the TCJA provides a transition rule under the new law allowing IRC § 1031 nonrecognition to a qualifying exchange of personal or intangible property if the taxpayer disposed of the exchanged property on or before December 31, 2017, or the taxpayer received replacement property on or before that date[2].

Determining Eligible Like-Kind Exchange Property

The TCJA amended IRC § 1031 to eliminate exchanges of personal and intangible property from qualifying for tax deferred treatment. With the exception of the transitional rules for certain exchanges of personal or intangible property beginning on or before December 31, 2017, only an exchange of real property will qualify for non-recognition of gain or loss after 2017.

To qualify for deferral of gain or loss, the exchanged property must be real property that is held for productive use in a trade or business or for investment. IRC § 1031(a). An exchange of real property held primarily for sale will not qualify as a like-kind exchange. IRC § 1031(a)(2). Exchanges of personal use property, such as a taxpayer's residence, will also not qualify.

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[1] The Tax Cuts and Jobs Act repealed Subsection 1031(i). However, the committee reports indicate a Congressional intent that certain types of mutual ditch, reservoir or irrigation stock continue to be treated as real property and remain eligible for non-recognition of gain or loss treatment if exchanged with other real property.

[2] The transition rule under Section 13303 of the Tax Cuts and Jobs Act is not in IRC § 1031 itself.

Properties are of a “like-kind” under Treas. Reg. §1.1031(a)-1(b) and (c) if they are of the same nature or character even if they differ in grade or quality. Real properties generally are of a like-kind, regardless of whether they are improved or not. For example, an apartment building would be of a like-kind to another apartment building or to an unimproved parcel of land held either for productive use in a trade or business or for investment.

Example #1: Tom simultaneously exchanges real property containing a single family residential rental structure for another residential lot containing a duplex he plans on renting to tenants. The property qualifies for like-kind exchange treatment. Both properties are real property and both properties are either being held for productive use in a trade or business or for investment under IRC § 1031(a). This is true regardless of what year the exchange occurs since the real property qualifies under TCJA and prior to the effective date of its implementation.

Example #2: Cindy owns vacant land for investment and wants to acquire rental property. Alex owns a multi-family apartment complex, all of which is rented, and wants to acquire land to build his new home. Cindy and Alex exchange properties on July 31, 2018. Since Cindy owned and held vacant land for investment purposes and is acquiring real property for rental purposes, i.e., property to be “held for the productive use in a trade or business or for investment,” the exchange will qualify for IRC § 1031 treatment as it relates to Cindy.

With respect to Alex, the exchange will not qualify for IRC § 1031 deferred recognition because Alex intends to use the land he acquired from Cindy for personal purposes and not for productive use in a trade business or for investment. It does not matter that the real property Alex relinquishes otherwise meets the qualifications under IRC § 1031. In a like-kind exchange, both the property relinquished and property received by a taxpayer must be qualifying property.

Example #3: Tom simultaneously exchanges an old tractor used in his farming trade or business for a new replacement tractor. If the exchange occurs on or before December 31, 2017, the exchange will qualify for deferred recognition of gain or loss under § 1031. If the exchange occurs after December 31, 2017, it will not qualify for deferred recognition treatment.

Example #4: The facts are the same as in Example #3 above, except Tom’s exchange is a deferred like-kind exchange and Tom uses a qualified intermediate (QI) to facilitate the like-kind exchange. He relinquishes the old tractor to the QI on December 28, 2017, but does not acquire another tractor until February 3, 2018. Since Tom relinquished the tractor on or before December 31, 2017, the exchange will qualify for like-kind exchange treatment under the transition rules of TCJA Section 13303(c) if all of the other requirements of IRC § 1031 are met.

Real property located within the United States is not considered like-kind to real property located outside the United States. IRC § 1031(h). Additionally, leaseholds of real property having at least 30 years to run are generally like-kind to fee simple interests in real property. Treas. Reg. § 1.1031(a)-1(c).

It is important to note that, when determining whether real property is of like-kind to other real property, all facts and circumstances are considered including state law and federal law classifications.

Example #5: In 2018, Jane decides to exchange a parcel of real property she owns and holds for investment purposes located in Toronto, Canada for another parcel of real property located in Burlington, Vermont. The property to be received will also be held for investment purposes. Regardless of whether the property would otherwise qualify for like-kind exchange treatment, IRC § 1031(h) precludes property located within the United States from being like-kind to property located outside the United States. Jane would be required to recognize any realized gain or loss on the exchange.

Audit Considerations to an IRC § 1031 exchange

The following is non-exclusive list of audit considerations when determining whether IRC § 1031 applies to an exchange:

1. Review the Form 8824 for completeness. Request supporting calculations substantiating amounts on the form.
2. Consider the type of exchange you have. The most common types of exchanges are as follows:
    a. A simultaneous, two-party exchange,
    b. A deferred forward exchange with a qualified intermediary, and
    c. A reverse exchange with an accommodating titleholder.

    A simultaneous, two-party exchange occurs when a taxpayer transfers property (relinquished property) to another party and, at the same time, receives property (replacement property) from the other party.

A deferred forward exchange occurs when a taxpayer transfers relinquished property and then, at a later date, receives replacement property. This exchange often involves the use of a qualified intermediary (QI). Per agreement with the taxpayer, a QI will "acquire" the relinquished property from the taxpayer, transfer it to a buyer, "acquire" replacement property from a seller, and transfer it to the taxpayer. The QI will also hold the sale proceeds from the transfer of the relinquished property until the date those funds are used to acquire the replacement property.

A reverse exchange occurs when a taxpayer "acquires" replacement property and then, at a later date, transfers the relinquished property. Because a transaction is not an exchange if the taxpayer holds title to the replacement property before transferring the relinquished property, a taxpayer doing a reverse exchange must use an exchange accommodation titleholder (or EAT) to hold title to the replacement property until the taxpayer transfers the relinquished property. Rev. Proc. 2000-37, as modified by Rev. Proc. 2004-51. This is called a "parking arrangement" because the replacement property is "parked" with an EAT.

3. Regarding deferred forward exchanges and reverse exchanges, ensure that the following requirements are met:

    a. In a deferred forward exchange, the replacement property must be identified within 45 days of the day the taxpayer transferred the relinquished property. Replacement property received within the 45-day identification period is considered to have been identified within the 45-day period. In a reverse exchange, the taxpayer must identify relinquished property within 45 days of the day the taxpayer parked the replacement property with an EAT. Relinquished property transferred within the 45-day period is considered to have been identified within the 45-day period.

    b. In a deferred forward exchange, a taxpayer must receive the replacement property(s) within 180 days of the transfer of the relinquished property or, if earlier, by the due date of the income tax return (including extensions) for the taxable year during which the taxpayer first transferred relinquished property. In a reverse exchange, the taxpayer must transfer relinquished property within 180 days of the day the replacement property was parked with an EAT or, if earlier, by the due date of the income tax return (including extensions) for the taxable year during which the taxpayer first parked replacement property with the EAT.

    IRC § 1031(a)(3) & Treas. Reg. § 1.1031(k)-1.

Example #6: Amanda transfers real property held for investment to a qualified intermediary in a forward exchange on June 3, 2018. She will have until July 18, 2018 (45 days after June 3, 2018), to provide the QI with an identification letter listing the properties she wishes to acquire. If the identification letter lists properties A, B & C and Amanda later receives properties A, B & D, Property D will not be considered like-kind under IRC § 1031(a)(3) since it was not identified within the 45-day period. Additionally, if an identified property is received after November 30, 2018 (180 days after June 3, 2018), that property will also be treated as not of like-kind to Amanda's relinquished property and thus not qualifying for replacement property.

4. Ensure the relinquished property and the replacement property are of a like-kind and not either held primarily for sale or held for personal use.

   Example #7: Karen is a dealer in real property. John owns real property that he uses in his trade or business. Karen and John exchange one of Karen's listed properties for John's property plus $100,000 cash. John intends to use Karen's property in his trade or business. Karen cannot use IRC § 1031 to defer gain on the exchange of her property because she held her relinquished property primarily for sale. Karen's amount of gain realized and recognized equals the FMV of John's real property plus the $100,000 cash she received less her adjusted basis of the real property she exchanged.

   However, John's exchange will qualify for IRC § 1031 treatment since his relinquished and replacement properties are held for productive use in a trade or business. John basis in his replacement property is the adjusted basis in the old property plus the $100,000 cash he paid for Karen's property.

5. Verify that the qualified intermediary (QI) meets the requirements under Treas. Reg. § 1.1031(k)-1(g)(4)(iii). The QI cannot be the taxpayer's agent. **Note**: For simultaneous transfers, a QI is permitted to be an agent of the taxpayer. Treas. Reg. § 1.1031(b)-2(a).

6. Determine if the exchange involved receipt of cash by the taxpayer. This is commonly referred to as "boot." Additionally, any property the taxpayer receives that is not of like-kind to the relinquished property is boot. A taxpayer's receipt of boot will trigger the recognition of gain to the extent of the lesser of (i) the realized gain, or (ii) the cash received plus the fair market value of the non-like-kind property the taxpayer receives in the exchange, but no losses are recognized. IRC § 1031(b) & (c).

Example #8: Henry exchanges a tract of farmland with an adjusted basis of $100,000 for another tract of farmland that has a FMV of $92,500. He also receives $4,000 in cash and a pickup truck with a FMV of $11,000. Since only real property qualifies for like-kind exchange treatment, Henry's receipt of the truck and cash means he must recognize gain on the exchange. He realizes a gain of $7,500. This is the sum of the FMV of the tract of farmland he receives, the FMV of the truck he receives, and the cash he receives, minus the adjusted basis of the farmland he traded ($92,500 + $11,000 + $4,000 – 100,000). Henry must include in income (recognize) all $7,500 of the gain because it is the lesser of the realized gain ($7,500) and the sum of the FMV of the non-like kind property and the cash received ($15,000). His basis in the properties he received is figured as follows:

Adjusted basis of old farmland	$100,000
Minus: Cash received	− 4,000
	$ 96,000
Plus: Gain recognized	+ 7,500
Total basis of properties received	$103,500

He would then allocate the basis of $103,500 first to the nonlike-kind property, the truck ($11,000). This is the truck's FMV. The rest ($92,500) is the basis in the farmland.

7. Determine if any indebtedness of the taxpayer was assumed or paid off as part of the like-kind exchange. Generally, if an indebtedness of the taxpayer is assumed by another party to the exchange or paid off in the exchange, the amount of the indebtedness is treated as boot. In certain instances, the taxpayer's indebtedness that is assumed or paid off can be offset by indebtedness the taxpayer assumes or incurs in the exchange. Treas. Reg. § 1.1031(d)-2.

8. Determine if the parties to the exchange are related as defined under IRC §§ 267(b) or 707(b)(1). Under IRC § 1031(f), if the exchange of properties is between related parties, any gain deferred by the related parties in the like-kind exchange (the first disposition) is triggered if one of the parties disposes of the exchanged property within two years of the first disposition (the second disposition). The gain that must be recognized under IRC § 1031(f) is recognized in the taxable year of the second disposition. IRC § 1031(f)(1).

Example #9: Jake owned real property used in his business. Jake's sister owned real property used in her business. In December 2018, Jake exchanged his real property plus $15,000 for his sister's real property. At that time, the fair market value of his real property was $200,000 and its adjusted basis was $65,000. The fair market value of his sister's real property was $215,000 and its adjusted basis was $70,000. Jake realized a gain of $135,000 (the $215,000 fair market value of the real property received minus the $15,000 Jake paid minus his $65,000 adjusted basis in the property). Jake's sister realized a gain of $145,000 (the $200,000 fair market value of Jake's real property plus the $15,000 he paid minus her $70,000 adjusted basis in the real property).

However, because this was a like-kind exchange and Jake received no cash or non-like kind property in the exchange, he recognized no gain on the exchange. Jake's basis in the real property he received was $80,000 (the $65,000 adjusted basis of the real property given up plus the $15,000 he paid). Jake's sister recognized gain only to the extent of the money she received, $15,000. Her basis in the real property she received was $70,000 (the $70,000 adjusted basis of the real property she exchanged minus the $15,000 received, plus the $15,000 gain recognized).

In 2019, Jake sells the real property he received to a third party for $220,000. Because he sells the property he had acquired in a like-kind exchange from a related party (his sister) within 2 years after the exchange with his sister, that exchange is disqualified from nonrecognition treatment and the gain deferred in 2018 must be recognized on his 2019 return. On his 2019 tax return, Jake must report his $135,000 gain on the 2018 exchange. He also must report the gain on the 2019 sale on his 2019 return.

Additionally, Jake's sister must report on her 2019 tax return the gain she deferred in 2018, $130,000, which is the $145,000 realized gain on the 2018 exchange minus the $15,000 she reported on her 2018 return. Her adjusted basis in the property is increased to $200,000 (the $70,000 basis computed in 2018 plus the $130,000 gain recognized on her 2019 return).

9. Review current, subsequent, and prior year tax returns for evidence of business, investment or personal use of the exchanged properties.

10. Search county real estate records and IRP documents for evidence of unreported real property exchanges or for information relating to reported exchanges.

11. Interview the taxpayer and determine the following:
    a. An overview of the exchange transaction, including the parties involved, a timeline, and how the exchange was executed;
    b. A description of the properties exchanged;
    c. How the exchanged properties were and are used;
    d. The taxpayer's relationship to the exchange facilitators (the QI and EAT, if used) and to other parties to the exchange;
    e. Whether the taxpayer owns property previously acquired in a §1031 exchange;
    f. Whether the taxpayer engaged in any exchanges during the current year that were not reported on Form 8824; and
    g. How the taxpayer computed the basis of properties acquired in an IRC § 1031 exchange.

12. A non-exclusive list of recommended items to request from the taxpayer when examining a IRC § 1031 exchange is as follows:
    a. Exchange agreement (between taxpayer and QI) and the agreement between the taxpayer and the EAT, if one is used
    b. Exchange summary (chronological listing of all transactions from start to finish)
    c. Written property identification (45-day requirement)
    d. Purchase and sales agreements for all properties
    e. Settlement sheets for all properties
    f. Documentation pertaining to any improvements made to exchanged property prior to its receipt

Summary

You are now able to identify changes to IRC § 1031 as a result of the TCJA. For exchanges that begin after December 31, 2017, only exchanges of real property held for investment or for use in a trade or business and certain mutual ditch, reservoir, or irrigation company stock that is treated as real property will qualify for like-kind exchange treatment.

You are now able to identify which property will qualify for an IRC § 1031 exchange. This includes whether or not real estate is considered like-kind to other real estate. Any cash or other property received that is not like-kind will trigger the recognition of gain, but not loss.

The above nonexclusive list of audit considerations will assist you in identifying IRC § 1031 exchanges, the type of information to request, what questions to ask the taxpayer, and how to determine potential unreported IRC § 1031 exchanges.

Tax Cuts and Jobs Act

Provision 13307

Denial of Deduction for Settlements Subject to Nondisclosure Agreements – Sexual Harassment/Abuse

Overview

Introduction

Provision 13307 concerns settlement of attorney's fees related to sexual harassment.

New Tax Provision

Prior Tax Law

There was no specific prior law applicable to this.

Sec 13307-Denial of Deduction for Settlements Subject to Nondisclosure Agreements – Sexual Harassment/Abuse

No deduction for certain payments made in sexual harassment or sexual abuse cases. For amounts paid or incurred after December 22, 2017, new section 162(q) provides that no deduction is allowed under section 162 for any settlement or payment related to sexual harassment or sexual abuse if it is subject to a nondisclosure agreement. In addition, attorney's fees related to such a settlement or payment are not allowed as a deduction.

Tax Cuts and Jobs Act

Provision 13310

Employee Achievement Awards

Overview

Introduction

Prizes and awards given to employees are generally both taxable to the employee and deductible by the employer. However, certain employee achievement awards are excludable from an employee's income but still deductible by the employer.

IRC 74(c) provides an exception to the general income inclusion rule and applies only to items of tangible personal property given to employees for length-of-service or safety achievement that do not exceed $400 per employee per year for nonqualified plan awards and $1,600 per employee per year for qualified plan awards. Qualified plan awards are those that are granted as part of an established written plan that does not discriminate in favor of the highly compensated and are awarded as part of a "meaningful" presentation.

This lesson will discuss the expanded definition of tangible personal property created by the new tax law for the purposes of employee achievement awards.

Objectives

At the end of this lesson, you will be able to identify changes made under Tax Cuts and Jobs Act (TCJA) regarding employee achievement awards.

Contents

Prior Tax Law

IRC 274 is a disallowance section describing various expenses or aspects of expenses that are not allowed as deductions, including items of:

1. Entertainment,
2. Amusement,
3. Recreation,
4. Travel,
5. Conventions,
6. Facilities, and
7. Employee achievement awards.

Prior to the revision, IRC 274(j)(3) defined the term “employee achievement award” as an item of tangible personal property which is:

- Transferred by an employer to an employee for length of service achievement or safety achievement,
- Awarded as part of a meaningful presentation, and
- Awarded under conditions and circumstances that do not create a significant likelihood of the payment of disguised compensation.

The new tax law expanded the definition of “tangible personal property” as described in IRC 274(j)(3).

New Tax Provision

TCJA section 13310 rearranged and expanded IRC 274(j)(3)(A) by adding new subsection (ii) to restrict the definition of "tangible personal property" that may be considered a deductible employee achievement award.

The code section now 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.

The change applies to amounts paid or incurred after December 31, 2017.

Audit Considerations

The following information can be used to identify whether the taxpayer provides unallowable tangible personal property as employee achievement awards:

- **Employer and employee interviews**: Discussions with the employer and the employees may give indications of whether employee achievement awards include unallowable items.

- **Employee Handbooks**: Many taxpayers maintain a written employee handbook outlining the benefits available to their employees. Fringe benefits such as awards are often described in these handbooks.

- **Employee Newsletters**: Many taxpayers publish a newsletter for employees, and include various uplifting stories including identifying employees recognized for achievement or job performance.

- **Employment Contracts**: Benefits that are provided on a discriminatory basis may be described in employment contracts with key personnel.

Summary

You are now able to identify changes made under Tax Cuts and Jobs Act (TCJA) regarding employee achievement awards.

Tax Cuts and Jobs Act

Provision 13402

Rehabilitation Tax Credit

Overview

Introduction

The investment tax credit is allowable for certain depreciable property including the rehabilitation of a qualified building.

Under prior law a qualified building may be eligible for one of two tax credits a:

- 20 percent credit for a qualified rehabilitation of a “certified historic structure”
- 10 percent credit for the rehabilitation of a non-historic building built before 1936

The Tax Cuts and Jobs Act of 2017 (TCJA) repealed the 10 percent credit for pre-1936 buildings for amounts paid or incurred after December 31, 2017. The Act retains the 20 percent credit for qualified rehabilitation expenditures with respect to a certified historic structure, with the modification that the qualified rehabilitation expenditures generally are allowed ratably during the 5-year period beginning in the tax year in which the qualified rehabilitated building is placed in service.

A transition rule is provided.

This lesson will explain the basic requirements to qualify for each credit, the transition rule and the carryforward of unused credit.

Objectives

At the end of this lesson, you will be able to:

- Determine the rehabilitation rules prior to the enactment of TCJA.
- Understand the application of the transition rule under the TCJA.
- Determine the credit allowable for rehabilitation projects that do not qualify under the transition rule.

Contents

Prior Tax Law

Qualified Rehabilitated Building

To be a qualified rehabilitated building, a building must meet all five of the following requirements.

1. The building must have been placed in service (see requirement four) prior to 1936 unless it is a certified historic structure. A certified historic structure is any building (a) listed in the National Register of Historic Places, or (b) located in a registered historic district (as defined in section 47(c)(3)(B)) and certified by the Secretary of the Interior as being of historic significance to the district. Certification requests are made through the State Historic Preservation Officer on National Park Service (NPS) Form 10-168a, *Historic Preservation Certification Application*, Part 1. The request for certification should be made prior to physical work beginning on the building.

2. The building must be substantially rehabilitated. A building is considered substantially rehabilitated if the qualified rehabilitation expenditures during a self-selected 24-month period that ends with or within the tax year are the greater of $5,000 or the adjusted basis in the building and its structural components. Figure adjusted basis on the first day of the 24-month period or the first day of the holding period, whichever is later. If the building is being rehabilitated in phases under a written architectural plan and specifications that were completed before the rehabilitation began, substitute “60-month period” for “24-month period.”

3. Depreciation must be allowable with respect to the building. Depreciation isn't allowable if the building is permanently retired from service. If the building is damaged, it isn't considered permanently retired from service where the taxpayer repairs and restores the building and returns it to actual service within a reasonable period of time.

4. The building must have been placed in service before the beginning of rehabilitation. This requirement is met if the building was placed in service by any person at any time before the rehabilitation began.

5. For a building other than a certified historic structure (a) at least 75 percent of the external walls must be retained with 50 percent or more kept in place as external walls, and (b) at least 75 percent of the existing internal structural framework of the building must be retained in place.

Qualified Rehabilitation Expenditures

To be a qualified rehabilitation expenditure (QRE), the expenditures must meet all six of the following requirements.

1. The expenditures must be for (a) nonresidential real property, (b) residential rental property (but only if a certified historic structure—see Regulations section 1.48-1(h)), or (c) real property that has a class life of more than 12.5 years.

2. The expenditures must be incurred in connection with the rehabilitation of a qualified rehabilitated building.

3. The expenditures must be capitalized and depreciated using the straight-line method.

4. The expenditures can't include the costs of acquiring or enlarging any building.

5. If the expenditures are in connection with the rehabilitation of a certified historic structure or a building in a registered historic district, the rehabilitation must be certified by the Secretary of the Interior as being consistent with the historic character of the property or district in which the property is located. This requirement doesn't apply to a building in a registered historic district if (a) the building isn't a certified historic structure, (b) the Secretary of the Interior certifies that the building isn't of historic significance to the district, and (c) if the certification in (b) occurs after the rehabilitation began, the taxpayer certifies in good faith that he or she wasn't aware of that certification requirement at the time the rehabilitation began.

6. The expenditures can't include any costs allocable to the part of the property that is (or may reasonably be expected to be) tax-exempt use property (as defined in section 168(h) except that “50 percent” shall be substituted for “35 percent”).

The Credit

If all of the requirements listed above are met, then the credit is 20 percent of the QREs for a certified historic structure and 10 percent of the QREs with respect to a Pre-1936 building. The credit is generally claimed in the year the property is placed in service.

A taxpayer may elect to claim the credit in the tax year when the expenses were paid under IRC 47(d). The building rehabilitation period is expected to be at least 2 years and it must be reasonable to expect that the building will be a qualified rehabilitated building when placed in service. This is the election for qualified progress expenditures.

The credit is claimed on Form 3468, *Investment Credit*.

Who May Claim the Credit

The owner of the property at the time the property is placed in service is entitled to the claim the credit.

If the owner elects to treat the lessee as the purchaser of investment credit property, then the lessee will be entitled to claim the credit. The information needed to claim a credit from an S Corporation, a partnership or an estate or trust will be provided by the entity to complete the necessary information.

Basis Impact

If the owner of the property claims the credit, the basis of the building will be reduced by the credit for depreciation purposes. If the credit is passed through to a lessee, the lessee will include in gross income the amount of the credit ratably over the depreciable life.

Recapture of Credit

The investment credit needs to be refigured and recaptured all or a portion of it if:

- It is disposed of before the end of 5 full years after the property was placed in service (recapture period);
- The use of the property changes before the end of the recapture period so that it no longer qualifies as investment credit property;
- The business use of the property decreases before the end of the recapture period so that it no longer qualifies (in whole or in part) as investment credit property;
- Any building to which section 47(d) applies that will no longer be a qualified rehabilitated building when placed in service (by reason of sale or other disposition, cancellation or abandonment of contract, or otherwise);

- Before the end of the recapture period, the proportionate interest is reduced by more than one-third in an S corporation, partnership (other than an electing large partnership), estate, or trust that allocated the cost or basis of property to you for which you claimed a credit;
- Leased property (on which you claimed a credit) is returned to the lessor before the end of the recapture period;
- Net increase in the amount of nonqualified nonrecourse financing occurs for any property to which section 49(a)(1) applies.

Recapture of the investment credit doesn't apply to any of the following.

- A transfer due to the death of the taxpayer.
- A transfer between spouses or incident to divorce under section 1041. However, a later disposition by the transferee is subject to recapture to the same extent as if the transferor had disposed of the property at the later date.
- A transaction to which section 381(a) applies (relating to certain acquisitions of the assets of one corporation by another corporation).
- A mere change in the form of conducting a trade or business if:
    a. The property is retained as investment credit property in that trade or business, and
    b. The taxpayer retains a substantial interest in that trade or business.
- A mere change in the form of conducting a trade or business includes a corporation that elects to be an S corporation and a corporation whose S election is revoked or terminated.

New Tax Provision

The Tax Cuts and Jobs Act (TCJA), signed December 22, 2017, affects the Rehabilitation Tax Credit for amounts that taxpayers pay or incur for qualified expenditures after December 31, 2017. The credit is a percentage of expenditures for the rehabilitation of qualifying buildings in the year the property is placed in service.

The legislation:

- Requires taxpayers take the 20-percent credit ratably over five years instead of in the year the qualified rehabilitated building is placed in service
- Eliminates the 10 percent rehabilitation credit for the Pre-1936 buildings

A transition rule provides relief to owners of either a certified historic structure or a Pre-1936 building by allowing owners to use the prior law if the project meets these conditions:

- The taxpayer owns or leases the building on January 1, 2018, and continues to own or lease the building at all times thereafter
- The 24- or 60-month period selected by the taxpayer for the substantial rehabilitation test begins by June 20, 2018

Audit Considerations

Although the TCJA eliminated the 10 percent credit and amended the 20 percent credit, the law generally retained the other requirements presented in the Prior Law section of these training materials.

The following determinations must be made:

- The building must have been in service prior to the rehabilitation
- If the transition rule applies, the building must have been owned or leased by the taxpayer on January 1, 2018 and at all times thereafter
- The building must be a qualified rehabilitated building. This requirement applies to Pre-1936 buildings and certified historic structures
    - A pre-1936 building must also meet wall retention requirements

- If in a national register district, the building must be decertified for a Pre-1936 or certified by the NPS as contributing to a district to qualify as a certified historic structure
- The rehabilitation of a certified historic structure also must be certified by the NPS

- The expenditures must be QREs (capital expenditures related to the building and structural components) and incurred in connection with the rehabilitation of a qualified rehabilitated building
- The year the qualified rehabilitated building was placed in service
- The substantial rehabilitation test must be met

The substantial rehabilitation test must end in in the year the building is placed in service. The taxpayer picks the date for the end of the test period. From the end date you go back 24 months or 60 months to determine the start date of the test period. To qualify under the transition rules the test date must begin by June 20, 2018.

The qualified expenditures during the test period must exceed the adjusted basis on the first day of the test period. If the test is not met, then no credit may be claimed. If the test period is met, then the taxpayer may claim the credit on qualified expenditures before the test period, during the test period and through the end of the year that the building is placed in service.

A credit claimed under the transition rules with a 24-month test period must be place in service no later than 2020 and a phase of a project placed in service under the 60-month rule must be placed in service no later than 2023.

While the taxpayer may be entitled to a credit in a current year, he may not be able to utilize it due to other limitations such as basis, at risk, and passive activity loss rules. In general, the credit can be carried back 1 year and forward 20 years.

For more detail go to the rehabilitation tax credit page on irs.gov.

Summary

Main Points

In order to claim a rehabilitation tax credit under the law prior law, a taxpayer must be the owner of a qualified property on January 1, 2018, and meet substantial rehabilitation test with a date beginning no later than June 20, 2018.

A non-historic Pre-1936 building not qualifying under the transition rules will no longer to be eligible for the credit. The Pre-TCJA rules continue to apply to a certified historic structure. However, the 20 percent credit will be claimed ratably over 5 years starting with the year the property is placed in service.

Tax Cuts and Jobs Act

Provision 13403

Paid Family and Medical Leave

Overview

Introduction

There are many non-refundable general and small business tax credits reportable on Form 3800, *General Business Credit.* The instructions to the form provide guidance on the ordering of allowable credits and the rules for allowable carry-forwards and carry-backs.

This lesson provides an overview of the newly created tax credit for paid family and medical leave to be reported on Form 3800 and calculated on new Form 8994, *Employer Credit for Paid Family and Medical Leave*.

Objectives

At the end of this lesson, you will be able to identify the general provisions of the paid family and medical leave tax credit.

Contents

New Tax Provision

Tax Cuts and Job Act (TCJA) section 13403 created IRC 45S, *Employer Credit for Paid Family and Medical Leave.* This new tax provision allows eligible employers to claim a general business credit from a minimum of 12.5 percent to a maximum of 25.0 percent of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave.

To claim the credit, employers must have a written policy that meets certain requirements:

- Provide at least two weeks of paid family and medical leave annually to all qualifying employees who work full time. (This can be prorated for employees who work part time.)
- Provide paid leave that is not less than 50 percent of the wages normally paid to the employee.

A “qualifying employee” is any employee who:

- Has been employed for one year or more, and
- For the preceding year, had compensation that did not exceed a certain amount. For 2018, the employee must not have earned more than $72,000 in 2017.

For purposes of this credit, “family and medical leave” is leave for one or more of the following reasons:

- Birth of an employee’s child and to care for the newborn.
- Placement of a child with the employee for adoption or foster care.
- To care for the employee’s spouse, child, or parent who has a serious health condition.
- A serious health condition that makes the employee unable to perform the functions of his or her position.
- Any qualifying event due to an employee’s spouse, child, or parent being on covered active duty – or being called to duty – in the Armed Forces.
- To care for a service member who is the employee’s spouse, child, parent, or next of kin.

The credit is a percentage of the amount of wages paid to a qualifying employee while on family and medical leave for up to 12 weeks per taxable year.

An employer must reduce its deduction for wages or salaries paid or incurred by the amount determined as a credit. Any wages considered in determining any other general business credit may not be used toward this credit.

The IRC 45S credit is first available for wages paid in tax years beginning after 2017 and expires for wages paid in tax years beginning after 2019. Thus, the credit is available for calendar and fiscal tax years beginning in 2018 and 2019.

Identifying a Qualifying Program for the General Business Tax Credit

The following information can be used to identify whether the taxpayer provides a program for employee family and medical leave that qualifies for the general business tax credit:

- **Employer and employee interviews**: Discussions with the employer and the employees would verify the existence of a qualified family medical leave program.
- **Employee Handbooks**: Many taxpayers maintain a written employee handbook outlining the benefits available to their employees.
- **Employee Newsletters**: Many taxpayers publish a newsletter for employees that include descriptions of the benefit programs and any changes made.
- **Employment Contracts**: Benefits may be described in employment contracts with key personnel.

Resources

Additional information regarding the credit can be found below:

- Section 45S Employer Credit for Paid Family and Medical Leave FAQs. Eight Frequently Asked Questions (FAQ).
- Notice 2018-71, *Employer credit for paid family and medical leave*. Contains 34 additional FAQs.
- Form 8994, *Employer Credit for Paid Family and Medical Leave*, and instructions for the form.

Summary

You are now able to identify the general provisions of the paid family and medical leave tax credit.

Tax Cuts and Jobs Act

Provision 13541

Expansion of Qualifying Beneficiaries of an Electing Small Business Trust

Overview

Introduction

The Tax Cuts and Jobs Act of 2017 (TCJA) expanded the types of persons who can be a potential current beneficiary of an Electing Small Business Trust (ESBT) to include a nonresident alien individual.

Objectives

At the end of this lesson, you will be able to describe how the changes made by the TCJA affect who can be a beneficiary of an ESBT.

Contents

Prior Tax Law

An electing small business trust (ESBT) may be a shareholder of an S corporation. Each potential current beneficiary of an ESBT is considered to be shareholder of the S corporation. Generally, the eligible potential current 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 therefore may not be a potential current beneficiary of an ESBT.

The portion of an ESBT which consists of the stock of an S corporation is treated as a separate trust and generally is taxed on its share of the S corporation's income at the highest rate of tax imposed on individual taxpayers, except for capital gains and qualified dividends that are taxed on the preferential tax rates applicable to those types of income. This income (whether or not distributed by the ESBT) is not taxed to the beneficiaries of the ESBT. If an ESBT is also a grantor trust, then the grantor trust rules supersede the ESBT rules and the grantor includes the S corporation's income in his gross income and the income is taxed at the marginal tax rates applicable to the grantor.

New Tax Provision

A nonresident alien individual may be a potential current beneficiary of an ESBT.

If the grantor portion of an ESBT is owned by a nonresident alien individual, then Proposed Regulations will state the income that normally would be allocated to the nonresident alien grantor under the grantor trust rules shall be reallocated to the ESBT portion of the trust and subject to tax at the highest rate of tax imposed on individual taxpayers (except for capital gains and qualified dividends).

This provision takes effect on January 1, 2018.

Audit Considerations

As part of the S corporation audit, the examiner should verify that each shareholder is a valid S corporation shareholder, and for an ESBT shareholder the examiner should verify that all potential current beneficiaries are allowable beneficiaries.

Summary

A nonresident alien shareholder is allowed to be a potential current beneficiary of an Electing Small Business Trust.

Tax Cuts and Jobs Act

Provision 13542

Charitable Contribution Deduction for Electing Small Business Trusts

Overview

Introduction

The change made by the Tax Cuts and Jobs Act of 2017 (TCJA) allows an Electing Small Business Trust (ESBT) to compute its deduction for charitable contributions passed through by an S corporation using the rules applicable to an individual.

Objectives

At the end of this lesson, you will be able to describe how the changes made by the TCJA affects the charitable contribution deduction for an ESBT.

Contents

Prior Tax Law

An Electing Small Business Trust (ESBT) may be a shareholder of an S corporation. The portion of an ESBT that consists of the stock of an S corporation (S portion) is treated as a separate trust and generally is taxed on its share of the S corporation's income at the highest rate of tax imposed on individual taxpayers. This income (whether or not distributed by the ESBT) is not taxed to the beneficiaries of the ESBT. In addition to non-separately computed income or loss, an S corporation reports to its shareholders their pro rata share of certain separately stated items of income, loss, deduction, and credit. For this purpose, charitable contributions (as defined in §170(c)) of an S corporation are separately stated and deducted by the shareholder.

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, rather than the deduction applicable to individuals, applies to the trust. Generally, a trust is allowed a charitable contribution deduction for amounts of gross income, without limitation, which pursuant to the terms of the governing instrument are paid for a charitable purpose. No carryover of excess contributions is allowed. An individual is allowed a charitable contribution deduction limited to certain percentages of adjusted gross income (AGI) generally with a five-year carryforward of amounts in excess of this limitation.

New Tax Provision

The charitable contribution deduction of the S portion 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 S portion of an ESBT.

The provision does not affect the taxable S portion of an ESBT that is a grantor trust and therefore is taxed under the grantor trust rules.

This provision applies to taxable years beginning after December 31, 2017.

Audit Considerations

The only charitable contributions that are deductible by the S portion of an ESBT are those that pass-through an S corporation as a separately-stated item shown on Sch. K-1.

The charitable deduction within the S portion of an ESBT is now subject to the same AGI limitations that are applicable to individuals. The AGI of the S portion of an ESBT is computed in the same manner as an individual taxpayer, except that administrative costs allocable to the S portion (to the extent they are costs incurred in the administration of the trust that wouldn't have been incurred if the property were not held by a trust) may be deducted in determining AGI.

Summary

The S portion of an ESBT that is not a grantor trust determines its charitable deduction using the rules applicable to individuals and may carry forward charitable deductions that cannot be used due to AGI limitations.

Tax Cuts and Jobs Act

Provision 13543

Modification of Treatment of S Corporation Conversions to C Corporation

Overview

Introduction

Provision 13543 of the Tax Cuts and Jobs Act (TCJA) modifies two areas of law involving conversions from S corporations to C corporation. Section 481 addresses changes in methods of accounting and section 1371 addresses certain distributions after the post-termination transition period (PTTP). The law, in part, provides some relief for certain S corporations who choose to convert.

This lesson will explain the basic law changes and explain who is impacted. It will also direct you where to find additional information.

Objectives

At the end of this lesson, you will be able to:

- Recognize the two sections of the code which were modified due to TCJA provision 13543.
- Identify C corporations that the rules apply.
- Determine where to find additional information.

Contents

Topic	See Page

Provision 13543

Amendment of Section 481

Section 13543 amended section 481 by adding the following new subsection:

(d) ADJUSTMENTS ATTRIBUTABLE TO CONVERSION FROM S CORPORATION TO C CORPORATION.

(1) IN GENERAL. In the case of an eligible terminated S corporation, any adjustment required by subsection (a)(2) which is attributable to such corporation's revocation described in paragraph (2)(A)(ii) shall be taken into account ratably during the 6-taxable year period beginning with the year of change.

(2) ELIGIBLE TERMINATED S CORPORATION. For purposes of this subsection, the term 'eligible terminated S corporation' means any C corporation—

(A) which—

(i) was an S corporation on the day before the date of the enactment of the Tax Cuts and Jobs Act, and

(ii) during the 2-year period beginning on the date of such enactment makes a revocation of its election under section 1362(a), and

(B) the owners of the stock of which, determined on the date such revocation is made, are the same owners (and in identical proportions) as on the date of such enactment.

Amendment of Section 1371

Section 1371 is amended by adding at the end the following new subsection:

(f) CASH DISTRIBUTIONS FOLLOWING POST-TERMINATION TRANSITION PERIOD.—In the case of a distribution of money by an eligible terminated S corporation (as defined in section 481(d)) after the post-termination transition period, 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 such accumulated adjustments account bears to the amount of such accumulated earnings and profits."

Analysis of Provision, Section 481

Accrual Method of Accounting

Generally, a C corporation (other than a farming business or a qualified personal service corporation) is prohibited from using the cash method of accounting unless the C corporation meets the $25 million gross receipts test (as adjusted for inflation) of section 448(c). Section 448 also prohibits tax shelters from using the cash method.

An S corporation does not have the same requirement. Therefore, if an S corporation converts to a C corporation, it may have to convert from the cash method to the accrual method of accounting. If the conversion from cash to accrual is required under section 448 then the corporation is required to report the positive or negative section 481(a) adjustment ratably over six years. There is no option to report the entire adjustment in the first year. However, if the method change is not required, but is permissible, then the corporation can choose to report the positive or negative adjustment over six years or follow the normal method change requirements of immediately or over four years depending upon whether the adjustment is positive or negative.

An eligible terminated S corporation is any C corporation that:

(1) is an S corporation on December 21, 2017, and

(2) revokes its S corporation election under section 1362(a) during the two-year period beginning December 22, 2017, and

(3) has all the same owners (and in identical proportions) on the date the S corporation election is revoked as on December 22, 2017.

For additional information, see Rev. Proc. 2018-44.

Analysis of Provision – Section 1371

Eligible Terminated S Corporation Period

When the S corporation status is terminated and the corporation continues to operate, the business is immediately treated as a C corporation. Therefore, any earnings generated after the termination date create earnings and profits for the C corporation. Also, any distribution made with respect to stock after the termination date would be from the C corporation and subject to the dividend rules of IRC § 301(c).

To facilitate the transition to C corporation status, in 1982 IRC § 1371(e) was enacted to allow **cash** distributions during the PTTP to be treated as a distribution from accumulated adjustments account (AAA) and, as such, to be tax-free up to the shareholder's basis in their stock. However, cash distributions in excess of the AAA will not be covered by the IRC § 1371(e) exception. The excess distributions will be treated as being made by the C corporation and subject to IRC § 301(c), i.e., they will be taxed as a dividend, assuming sufficient current year earnings & profits (CY E&P) or prior year accumulated earnings & profits (AE&P). In general, the PTTP is only for about the first year after the S election is terminated.

Under the provision 1371(f), Congress provided some transitional relief to certain "eligible terminated S corporations". For eligible terminated S corporations, any distribution of money outside the PTTP that is not sourced from CY E&P may be sourced as a ratio of AAA and AE&P. Distribution of money from AAA will be tax-free up to the shareholder's basis in their stock.

An eligible terminated S corporation is any C corporation that:

(1) is an S corporation on December 21, 2017, and

(2) revokes its S corporation election under section 1362(a) during the two-year period beginning December 22, 2017, and

(3) has all the same owners (and in identical proportions) on the date the S corporation election is revoked as on December 22, 2017.

Additional guidance is pending.

For more information see the Distributions and the Post-Termination Transition Period and After the Post-Termination Transition Period discussion in the S Corporation Distributions Issue Guide.

Audit Considerations

Both changes made by the provision are generally taxpayer favorable. However, they apply to specific C corporations that had converted from S corporation status during a particular period of time. If it is determined the taxpayer has relied on these provisions, the following should be verified:

- The entity was an S corporation on December 21, 2017,
- The S corporation revoked its election under section 1362(a) during the two-year period beginning December 22, 2017, and
- has all of same owners (and in identical proportions) on the date the S corporation election is revoked as on December 22, 2017.

Summary

Main Points

The law change provides a temporary rule for certain taxpayers when an S corporation converts to a C corporation.

- Changes from cash to accrual method of accounting may be reported ratably during the six-taxable-year period beginning with the year of change. Rev. Proc. 2018-44 provides additional guidance to taxpayers.
- Additional nondividend distributions may be provided by eligible terminated S corporations even after the post termination transition period ends. Additional guidance is pending.

Tax Cuts and Jobs Act

Provision 13821

Modification of Tax Treatment of Alaska Native Corporations and Settlement Trusts

Overview

Introduction

The Tax Cuts and Jobs Act of 2017 (TCJA) modified the tax treatment Alaska Native Corporations and Alaska Settlement Trusts by adding new Codes §§ 139G and 247 and revising the reporting requirements of § 6039H.

Native Corporations and Settlement Trusts, as well as their shareholders and beneficiaries, generally are subject to tax under the same rules and in the same manner as other taxpayers that are corporations, trusts, shareholders, and beneficiaries. These new provisions allow a Native Corporation to assign certain payments to a Settlement Trust without having to recognize gross income and to elect to deduct contributions made to a Settlement Trust. A Settlement Trust must include in gross income the assigned payments and the contributions received from the Native Corporation. Collectively, the provisions eliminate corporate tax on income transferred to the trust.

New § 139G allows a Native Corporation to assign certain payments to a Settlement Trust without having to recognize gross income from those payments. The Settlement Trust is required to include the assigned payment in income when received.

Objectives

At the end of this lesson, you will be able to:

- Describe how the changes made by the TCJA affect Alaska Native Corporations
- Describe how the changes made by the TCJA affect Alaska Settlement Trusts

Contents

Prior Tax Law

The Alaska Native Claims Settlement Act (ANCSA) established Native Corporations to hold property for Alaska Natives. Alaska Natives are generally the only permitted common shareholders of those corporations unless a Native Corporation specifically allows other shareholders under specified procedures. ANCSA permits a Native Corporation to transfer money or other property to an Alaska Native Settlement Trust (Settlement Trust) for the benefit of beneficiaries who constitute all or a class of the shareholders of the Native Corporation, to promote the health, education and welfare of beneficiaries and to preserve the heritage and culture of Alaska Natives.

Native Corporations and Settlement Trusts, as well as their shareholders and beneficiaries, are generally subject to tax under the same rules and in the same manner as other taxpayers that are corporations, trusts, shareholders, or beneficiaries. Payments received by a Native Corporation for the sharing of revenues generated by natural resources are includable in the gross income of the corporation and subject to the corporate income tax. Contributions of appreciated property by a Native Corporation to a Settlement Trust are taxable to the Native Corporation.

Internal Revenue Code § 646 allows a Settlement Trust to elect to use a more favorable tax regime for transfers of property received from a Native Corporation. A Settlement Trust makes this election by filing Form 1041-N, *U.S. Income Tax Return for Electing Alaska Native Settlement Trusts*. This election also includes reporting to beneficiaries, as described in § 6039H. An electing Settlement Trust pays tax on its taxable income at the lowest rate specified for individuals (rather than the higher rates that are generally applicable to trusts) and pays tax on capital gains at a rate consistent with being subject to such lowest rate of tax.

A distribution from an electing Settlement Trust is excludable from the gross income of beneficiaries to the extent of the taxable income of the Settlement Trust for the taxable year and all prior taxable years for which an election was in effect, decreased by income tax paid by the Trust, and increased by tax-exempt interest from State and local bonds for the same period. Distributions that exceed the excludable amount are taxed to the beneficiaries as if distributed by the sponsoring Native Corporation in the year of distribution by the trust, which means that the beneficiaries must include in gross income as dividends the amount of the distribution, up to the current and accumulated earnings and profits of the Native Corporation. Distributions that exceed the current and accumulated earnings and profits are not included in gross income by the beneficiaries.

New Tax Provision

TJCA does not change the basic tax regime applicable to electing §646 Settlement Trusts or to Settlements Trusts that did not made the § 646 election. This provision comprises three separate but related Internal Revenue Code sections.

New IRC § 139G, Assignments to Alaska Native Settlement Trusts

The new Code section allows a Native Corporation to assign certain payments described in ANCSA to a § 646 electing Settlement Trust without having to recognize gross income from those payments, provided the assignment is in writing and the Native Corporation has not received the payment prior to assignment. The Settlement Trust is required to include the assigned payment in gross income when received. This Code section is effective for taxable years beginning after December 31, 2016.

New IRC § 247, Contributions to Alaska Native Settlement Trusts

This new Code section allows a Native Corporation to elect annually to deduct contributions made to a Settlement Trust. If the contribution is in cash, the deduction is the amount of cash contributed. If the contribution is property other than cash, the deduction is the amount of the Native Corporation's basis in the contributed property (or the fair market value of such property, if less than the basis), and no gain or loss can be recognized on the contribution. The Native Corporation's deduction is limited to the amount of its taxable income for that year, and any unused deduction may be carried forward 15 additional years. The Native Corporation's earnings and profits for the taxable year are reduced by the amount of any deduction claimed for that year.

Generally, the Settlement Trust must include income equal to the deduction taken by the Native Corporation. For contributions of property other than cash, the Settlement Trust takes a basis in the property equal to its basis in the hands of the Native Corporation immediately before the contribution (or the fair market value of such property, if less than the corporation's basis), and may elect to defer recognition of income associated with such property until the Settlement Trust sells or disposes of the property. In that case, any income that is deferred is treated as ordinary income, while any gain in excess of the amount that is deferred takes the same character as if the election had not been made. The Settlement Trust's holding period includes the period the property was held by the Native Corporation.

The Settlement Trust may revoke this election by timely-filing an amended income tax return. If the Settlement Trust disposes of property subject to this election within the first taxable year after the taxable year in which the property was contributed to the Settlement Trust, the election is voided with respect to the property and the Settlement Trust is required to pay any tax applicable to the disposition of the property, including interest, as well as an additional tax equal to 10 percent of the amount of the tax. There is a four-year period to assess the tax and interest.

A Native Corporation may elect to deduct contributions to a Settlement Trust for taxable years for which the corporation's refund statute has not expired. If the refund statute for a taxable year expires before December 22, 2018, then there is a one-year waiver of the refund statute.

New IRC § 6039H(e), Reporting Requirements for a Native Corporation

A Native Corporation which has made an election to deduct contributions to a Settlement Trust must furnish a statement to the Settlement Trust containing:

- the total amount of contributions;
- whether such contribution was in cash;
- for non-cash contributions, the date that such property was acquired by the Native Corporation and the adjusted basis of such property on the contribution date;
- the date on which each contribution was made to the Settlement Trust; and
- such information as the Secretary determines is necessary for the accurate reporting of income relating to such contributions.

This new reporting requirement applies to taxable years beginning after December 31, 2016.

Audit Considerations

The primary compliance issue with respect to these provisions is that, other than by inspecting the relevant income tax returns, it is not possible to match the exclusion of income or deduction claimed by the Native Corporation with the corresponding income inclusions by the Settlement Trust. Because of the relationship between the Native Corporation and the Settlement Trust, an examiner auditing one entity will have to review the tax return of (or expand the examination to include) the other entity to ensure consistent tax treatment of the income assignment or contributions.

In effect, the provisions allow a Native Corporation to reduce or eliminate its taxable income by assigning eligible income to a Settlement Trust or by taking a tax deduction for cash and non-cash property contributed to a Settlement Trust. Examiners auditing a Native Corporation should inquire whether the corporation assigned income to a Settlement Trust or contributed property to a Settlement Trust for which the Native Corporation elected to deduct the value of the contributed property.

If the Native Corporation assigned income to a Settlement Trust, the examiner should confirm the corporation assigned qualified income, verity the assignment was in writing to an electing § 646 Settlement Trust, and review the income tax return of the Settlement Trust to determine whether the trust reported the assigned income.

If the Native Corporation elected to deduct contributions of property to the Settlement Trust, the examiner should verify the corporation correctly computed its basis in any non-cash property contributed to the Settlement Trust and provided the Settlement Trust with the statement required under § 6039H(e). The examiner also should review the trust return to determine whether the Settlement Trust reported the contribution as income, or in the case of a contribution of non-cash property, elected to defer the recognition of income.

The taxability of distributions from a § 646 Settlement Trust depend upon the earnings and profits of the Native Corporation. Therefore, where there are examination changes that affect the earnings and profits of the corporation the examiner must review the tax return of the § 646 Settlement Trust to determine the tax effect, if any, on the beneficiaries who received distributions from the trust.

Summary

Main Points

- Alaska Native Corporations may assign certain payments, in writing, to a §646 Settlement Trust without including these payments in gross income.

- Native Corporations may elect to deduct contributions of properties to a Settlement Trust.
  - If a Native Corporation contributes cash to a Settlement Trust, then the corporation receives a deduction equal to the amount of cash contributed to the trust.
  - If a Native Corporation contributes non-cash property to a Settlement Trust, then the corporation receives a deduction equal to the lesser of its basis in the property or the fair market value of the property.
  - The Native Corporation does not recognize gain or loss on the contributions.
  - The corporate deduction is limited to taxable income, and any excess may be carried forward for 15 years.
  - The earnings and profits of the corporation for the taxable year are reduced by the amount of the deduction.
  - The Settlement Trust's basis in non-cash property received from a Native Corporation is the lesser of the contributing corporation's basis in the property or the fair market value of the property at the time of contribution.
  - A Settlement Trust may elect to defer the recognition of income for non-cash property until such property is sold.
  - When a Settlement Trust disposes of property for which it made an election to defer the gain, then the income that would have been recognized by the trust if the election were not made is ordinary income, and any excess is treated in the same manner had the election not been made.
  - An early disposition of non-cash property by a Settlement Trust invalidates the election and the trust must pay the tax due on the previously-deferred income, plus an additional 10 percent tax, and interest.
  - A Native Corporation must provide a statement to the Settlement Trust that contains information specified in the statute.

Tax Cuts and Jobs Act

Provision 13822

Amounts Paid for Aircraft Management Service

Overview

Introduction

Section 13822 of Public Law 115-97, known as the Tax Cuts and Jobs Act (TCJA), created an exemption from federal excise tax for certain payments made by an aircraft owner (or, in certain cases, a lessee) related to the management and operation of aircraft. The exemption is codified as IRC § 4261(e)(5)

This exemption generally applies to maintenance and support of the aircraft owner's aircraft, and on flights by the aircraft owner on their own aircraft.

Objectives

At the end of this lesson, you will be able to:

- Determine when payments for aircraft management services are exempt from federal excise tax under IRC § 4261 and IRC § 4271.
- Determine what types of payments for aircraft management services are exempt from federal excise tax under IRC § 4261 and IRC § 4271.
- Determine when federal excise taxes under IRC § 4261 and IRC § 4271 are due on amounts paid for charters on managed aircraft.

Contents

Tax Law Overview

Excise Tax on Taxable Transportation by Air

For domestic passenger transportation, IRC § 4261 imposes an excise tax on amounts paid for taxable transportation. In general, for domestic flights, the tax consists of two parts: a 7.5 percent tax applied to the amount paid, and a fixed amount for each flight segment (consisting of one takeoff and one landing). “Taxable transportation” generally means transportation by air which begins and ends in the United States. The tax is paid by the person making the payment subject to tax and the tax is collected by the person receiving the payment.

For commercial freight aviation, IRC § 4271 imposes an excise tax of 6.25 percent of the amount paid for taxable transportation.

In determining whether a flight constitutes taxable transportation and whether the amounts paid for such transportation are subject to tax, the Internal Revenue Service (“IRS”) generally looks at who has “possession, command, and control” of the aircraft based on the relevant facts and circumstances.

Applicability to Aircraft Management Services Prior to the Enactment of IRC § 4261(e)(5)

Generally, an aircraft management services company (“management company”) has as its business purpose the management of aircraft owned by other corporations or individuals (“aircraft owners”). In this function, management companies provide aircraft owners, among other things, with administrative and support services (such as scheduling, flight planning, and weather forecasting), aircraft maintenance services, the provision of pilots and crew, and compliance with regulatory standards. Although the arrangement between management companies and aircraft owners may vary, aircraft owners generally pay management companies a monthly fee to cover the fixed expenses of maintaining the aircraft (such as insurance, maintenance, and recordkeeping) and a variable fee to cover the cost of operating the aircraft (such as the provision of pilots, crew, and fuel).

In March 2012, the IRS issued a nonprecedential legal opinion that determined that a management company provides all of the essential elements necessary for providing transportation by air and that the aircraft owner relinquishes possession, command and control to the management company. Thus, the legal opinion concluded that the management company provides taxable transportation to the aircraft owner and is required to collect the appropriate federal excise tax from the aircraft owner and remit it to the IRS.

New Tax Exemption for Certain Aircraft Management Services

IRC § 4261(e)(5) exempts certain payments related to the management of aircraft from the excise taxes imposed on taxable transportation by air. Exempt payments are those amounts paid by an aircraft owner for aircraft management services related to maintenance and support of the aircraft owner's aircraft or flights on the aircraft owner's aircraft.

Additionally under the provision, a lessee of an aircraft is considered to be an aircraft owner provided that the lease is not a "disqualified lease." A disqualified lease is any lease of an aircraft from an aircraft management company (or a related party) for a term of 31 days or less.

Aircraft management services that are not subject to tax include:

- Support activities related to the aircraft itself, such as:
  - Storage
  - Maintenance
  - Fueling
- Services related to the aircraft's operation, such as:
  - Hiring and training of pilots and crew

- Administrative services, such as:
  - Scheduling
  - Flight planning
  - Weather forecasting
  - Obtaining insurance
  - Establishing and complying with safety standards, and
- Services necessary to support flights operated by an aircraft owner.

Audit Considerations

Tax Consequences Should be Evaluated on a Flight by Flight Basis

Because the air transportation excise taxes and the aircraft management exemption apply on a flight-by-flight basis, revenue agents must look at the amount paid for each flight.

Payments for flight services are exempt from tax under IRC § 4261and IRC § 4271 only to the extent that they are attributable to flights on an aircraft owner's own aircraft. Thus, if an aircraft owner makes a payment to a management company for the provision of a pilot – and the pilot provides services on the aircraft owner's aircraft – such payment is not subject to Federal excise tax. However, if the pilot provides services to the aircraft owner on an aircraft other than the aircraft owner's aircraft (for instance, on an aircraft that is part of a fleet of aircraft available for third-party charter services), then such payment is subject to Federal excise tax.

IRC § 4261(e)(5) also provides a pro rata allocation rule in the event that a payment made to a management company is allocated in part to exempt services (i.e., flights on the aircraft owner's aircraft), and in part to non-exempt services (i.e., flights on aircraft other than the aircraft owner's aircraft). In such a circumstance, Federal excise tax must be paid on that portion of the payment attributable to flights on aircraft not owned by the aircraft owner.

Sometimes an aircraft owner will permit the management company to charter the aircraft owner's aircraft when not in use by the aircraft owner. When the aircraft is engaged in such a charter flight, amounts paid by the person chartering the aircraft are subject to the IRC § 4261 and IRC § 4271 taxes (as appropriate to the nature of the flight), unless another exemption applies.

Examples of Arrangements that Do Not Qualify as Aircraft Ownership under IRC § 4261(e)(5)

- Ownership of stock in a commercial airline cannot qualify the stock owner as an "aircraft owner" of a commercial airline's aircraft, and amounts paid for aircraft management services as well as amounts paid for transportation on such flights remain subject to the tax under IRC § 4261.

- Participation in a fractional aircraft ownership program does not constitute aircraft ownership for purposes of the IRC § 4261(e)(5) exemption. However, amounts paid to a fractional aircraft ownership program for transportation under such a program are exempt from air transportation excise tax under IRC § 4261(j) if the aircraft is operating under subpart K of part 91 of title 14 of the Code of Federal Regulations ("subpart K"). Such flights are subject to both the IRC § 4081 tax on kerosene used in aviation (the noncommercial aviation rate applies) and the additional fuel surtax under IRC § 4043.

- A business arrangement seeking to circumvent the IRC § 4043 surtax on fuel used on fractionally-owned aircraft (by operating outside of subpart K, allowing an aircraft owner the right to use any of a fleet of aircraft, be it through an aircraft interchange agreement, through holding nominal shares in a fleet of aircraft, or any other arrangement that does not reflect true tax ownership of the aircraft being flown upon) is not considered aircraft ownership for purposes of the exemption provision.

- A lessee that leases an aircraft for a period of 31 days or less is not an "aircraft owner".

Audits Prior to Enactment of IRC § 4261(e)(5)

Although the exemption for amounts paid for certain aircraft management services enacted as part of the TCJA became effective December 23, 2017, the IRS will not pursue the IRC § 4261 tax on amounts paid for aircraft management services prior to the enactment of the exemption if such amounts paid would have been exempt under IRC § 4261(e)(5) if the provision was in effect at the time of payment.

Summary

Main Points

Effective December 23, 2017, certain payments made by an aircraft owner (or, in certain cases, a lessee) related to the management and operation of aircraft are exempt from the excise taxes imposed on taxable transportation by air.

This exemption generally applies to maintenance and support of the aircraft owner's aircraft, and on flights by the aircraft owner on their own aircraft.

Although the exemption for aircraft management fees created by the TCJA became effective December 23, 2017, the IRS will not pursue excise tax on amounts paid for aircraft management services prior to the enactment of the exemption if such amounts paid would have been exempt under IRC 4261(e)(5) if the provision was in effect at the time of payment.