The New Tax Law

A SUMMARY OF
"AN ACT TO PROVIDE FOR RECONCILIATION PURSUANT TO TITLES II AND V OF THE CONCURRENT RESOLUTION ON THE BUDGET FOR FISCAL YEAR 2018."
(PUB. L. NO. 115-97)

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A Summary of "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018."
(Pub. L. No. 115-97)

Pub. L. No. 115-97, originally known as the "Tax Cuts and Jobs Act", was signed into law by President Trump on December 22, 2017. This is probably the most extensive revision to the provisions of the Internal Revenue Code during the lifetime of most readers and its impact will be significant for individuals, corporations and other business entities, both domestic and foreign.

As discussed in more detail below, the Act's provisions will impact business income and have implications both at the entity and investor/owner levels. In the context of cross-border and international planning, there has been a massive change in the way US shareholders of foreign corporations will be taxed. This includes a general repeal of the taxation of dividends paid by foreign corporations and an incentive for domestic corporations to increase income derived from foreign parties, and paradoxically, a new minimum tax imposed with respect to "base erosion" techniques utilized to reduce the US tax base and new taxes on low taxed foreign intangibles income derived by US persons.

New limitations on deductions have also found their way into the Code, such as the limitation on deductibility of business interest in place of the "earnings-stripping" provisions which previously applied only to related party loans. Interestingly, this provision, as well as some others, are very similar to provisions in the OECD's "Base Erosion and Profit Shifting" ("BEPS") Action Plan. Thus, BEPS seems to be having some influence on US tax law.

Below are some significant provisions in the Act. After reviewing some of the Act's provisions, some Planning Observations are set forth.

REFORM OF TAXATION OF BUSINESS INCOME

Significant revisions made by the Act to the taxation of business income include:

- **Corporate Income Tax Rate.** The Act reduces the corporate income tax rate to a flat 21% tax rate. (Note: the top marginal corporate income tax rate was 35% before the Act.) The alternative minimum tax ("AMT") on corporations has been repealed. These changes are effective for 2018 and later years.

- **Dividends Received Deduction.** The 80% dividends received deduction is reduced to 65%, and the 70% dividends received deduction is reduced to 50% for years beginning after 2017.[1]

- **Limitations on Deduction of Business Interest.** Before the effective date of the Act, the "earnings stripping" rules set forth in Section 163(j) limited only the deduction for certain related-party interest. The Act repeals these earnings stripping rules and replaces them with a new limitation on the deductibility of business interest. New Section 163(j) now limits a deduction for business interest expense (whether it is incurred on related or unrelated party debt) to an amount up to the taxpayer's business interest income plus 30% of its "adjusted taxable income."[2] Also, the limitation under the Act applies regardless of whether the business is conducted in corporate or pass-through form and is computed at the corporate or partnership (rather than the partner) level. Any business interest that isn't deductible because it exceeds the business interest limitation will be carried forward indefinitely.[3] The Act exempts from this limitation taxpayers with average annual gross receipts that do not exceed $25 million for the three taxable year period ending with the prior taxable year. Also, an electing real property trade or business isn't a "trade or business" for purposes of the business interest limitation. An "electing real property trade or business" is generally any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business" that elects such treatment.[4] Once made, the election is irrevocable. An electing real property trade or business must use the alternative depreciation system ("ADS") to depreciate any of its non-residential real property, residential rental property and qualified improvement property which requires use of a longer depreciable period.[5]

- **Limitations on Carryback and Carryforward of Net Operating Losses ("NOLs").** The Act generally eliminates the carryback of NOLs,[6] subject to a few

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[1] This amendment was necessary to maintain the effective tax rate on intercompany dividends after the drop in the general corporate tax rate to 21%.

[2] Essentially, "adjusted taxable income" means EBITDA until 2022 when EBITDA will be replaced by EBIT.

[3] This provision is similar to the OECD's Base Erosion and Profit Shifting Action 4.

[4] This definition includes any such real property trade or business, including a trade or business conducted by a corporation or real estate investment trust (REIT).

[5] This should not be a concern with real estate development for sale (including condominium development) since such property is generally not depreciable.

[6] A net operating loss (NOL) generally is the amount by which a taxpayer's current-year business deductions exceed its current-year gross income. Before the Act, NOLs could be carried back two years and carried forward 20 years to offset taxable income in such years.

exceptions. A corporation's ability to deduct a carryforward NOLs is limited to 80% of its taxable income determined without regard to any NOLs. Any unutilized NOLs can be carried forward indefinitely. These changes are generally effective for NOLs arising in tax years beginning after 2017.

- **Section 179 and Bonus Depreciation/ and Depreciation.** In recent years the annual cost recovery of depreciable property has generally been the sum of three separate deductions. These are (i) the "Section 179 deduction" which has been 100% of qualified property up to a dollar limitation (previously $500,000), (ii) Bonus Depreciation with respect to the remaining basis which before the Act had been up to 50%, and finally (iii) depreciation of the remaining basis after first subtracting both the Section 179 deduction and Bonus Depreciation. The Act makes changes to each of these components.

  - **Section 179 deduction (first-year expensing deduction).** Under the Act, businesses can now expense up to $1,000,000 of the cost of any "section 179 property" placed in service in a taxable year. However, if the section 179 property placed in service is more than $2.5 million in a taxable year, the amount available for immediate expensing is reduced by such excess. The Act modifies the expensing limitation by indexing both the $1 million and $2.5 million limits for inflation.[7]

  - **Bonus Depreciation/100% Expensing (Temporary).** Under the Act a 100% first-year deduction for its adjusted basis is allowed for qualified property acquired and placed in service after Sept. 27, 2017, and before Jan. 1, 2023 and is now allowed for both new and used property. The 100% allowance is phased down by 20% per calendar year for property placed in service in taxable years beginning after 2022 with total expiration after 2026.

  - **Shorter recovery periods for certain real property.** For property placed in service after 2017, the ADS recovery period for residential rental property is shortened from 40 years to 30 years.

- **20% deduction for qualifying business income ("QBI") derived by individuals and trusts from "pass-through" entities.** Individuals and trusts who are S corporation shareholders, partners in a partnership (or members of an LLC treated as a partnership) or owners of a sole proprietorship, are subject to tax at the individual owner or shareholder, partner or owner level rather than the entity level. Net income earned by such holders of interests in these entities report their share

[7] Note, however, that because the Act now makes Bonus Depreciation available at a 100% rate through 2022 (after which it is incrementally phased out through 2026) and makes it available for new as well as used property, Section 179 currently confers no benefit that is not otherwise available with Bonus Depreciation.

on their respective income tax returns and are subject to ordinary income tax rates, up to the top individual marginal rate (37% under the Act). Generally, for years

beginning after 2017 and before 2026, the Act allows a deduction equal to 20% of "qualified business income" ("QBI") derived by such interest holders. Individuals investing in partnerships and real estate rentals may benefit meaningfully from this proposal, since QBI income that would otherwise be subject to a 37% maximum rate may be eligible for a maximum effective rate of 29.6%. In the case of specified service businesses,[8] availability for the lower tax rate begins phasing out as a taxpayer's taxable income exceeds $315,000 for married individuals filing jointly ($157,500 for other individuals),[9] both indexed for inflation after 2018. A similar taxable income based phase-out also applies to non-service income which limits the QBI deduction to the greater of the owner's share of (i) 50% of the amount of W-2 wages paid to employees by the qualified business during the tax year, or (ii) the sum of 25% of W-2 wages plus 2.5% of the cost of qualified property.[10] The Act also allows the 20% deduction with respect to certain dividends received from REITs.

- **Carried Interests.** The Act effectively imposes a 3-year holding period in order for certain partnership interests received in connection with the performance of services to be taxed as long-term capital gain. If the 3-year holding period is not met with respect to an applicable partnership interest held by the taxpayer, the taxpayer's gain will be treated as short-term gain taxed at ordinary income rates.

- **Payments Related to Sexual Harassment/Abuse Covered by NDA.** Effective for amounts paid or incurred after Dec. 22, 2017, a business expense deduction will no longer be allowed for amounts paid in settlement, payout, or as attorney's fees related to claims covering sexual harassment or sexual abuse, if the settlement or payments are subject to a nondisclosure agreement.

- **Nondeductible Penalties and Fines.** No deduction is allowed for any otherwise deductible amount paid or incurred (whether by suit, agreement, or otherwise)

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[8] "Specified service businesses" are any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its owners or employees; and trades or businesses that involve the performance of services that consist of investment-type activities.

[9] The benefit of the deduction for service businesses phases out over the next $100,000 of taxable income for joint filers ($50,000 for other individuals) and is completely unavailable when taxable income attains $415,000 filing jointly and $207,500 for other individuals.

[10] Qualified property is the depreciable tangible property (including real estate) owned by a qualified business as of year-end and used by the business at any point during the tax year for the production of qualified business income.

pursuant to, or at the direction of, a government or specified nongovernmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law. Payments qualifying as "restitution" are excepted. This applies to amounts paid or incurred on or after Dec. 22, 2017.

- **One Million Dollar Limit on Executive Compensation Deduction.** The Act repeals the exceptions to the $1 million deduction limitation applicable to publicly held corporations for commissions and performance-based compensation. The definition of "covered employee" is revised to include the principal executive officer, the principal financial officer, and the three other highest paid officers.

- **Repeal of Partnership Technical Termination.** Effective for years after 2017, the Act repeals the rule that if within any 12-month period, there is a sale or exchange of 50% or more of the total interest in partnership capital and profits, the partnership is terminated.

- **Look-Through Rule Applied to Gain on Sale of Partnership Interest.** For sales and exchanges on or after Nov. 27, 2017, gain or loss from the sale or exchange of a partnership interest is effectively connected with a U.S. trade or business to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange. Any gain or loss from the hypothetical asset sale by the partnership must be allocated to interests in the partnership in the same manner as non-separately stated income and loss.[11] For sales, exchanges, and dispositions after 2017, the transferee of a partnership interest must withhold 10% of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that the transferor is not a nonresident alien individual or foreign corporation.

- **Post-2021 research and experimentation ("R & E") expenses**. Certain R & E expenses paid or incurred after 2021 in connection with a trade or business must be capitalized and amortized ratably over a 5-year period (15 years if conducted outside the U.S.). These include expenses for software development, but not expenses for land, or depreciable or depletable property used in connection with the R & E (but do include the depreciation and depletion allowance for such property). R&E expenses paid or incurred before 2022, are deductible or may be capitalized and recovered over the useful life of the research (not to exceed 60 months), or over a ten-year period, at the taxpayer's election.

[11] This provision overrules the result in the recent Tax Court case of Grecian Magnesite.

INTERNATIONAL TAX PROVISIONS

Various provisions included in the bill which have an impact on cross border investment include:

- **Territorial Tax Regime Introduced.** The Act changes the basis of taxation of income of US corporations to a "territorial" or "participation exemption" system (many nations, including Canada have a similar system). Under the Act, the "foreign source portion" of dividends paid by foreign corporations to a U.S. corporate shareholder that owns 10% or more of the foreign corporation will effectively be tax exempt because of the deduction for dividends received, or "DRD". The foreign-source portion of a dividend from a specified 10%-owned foreign corporation is that amount which bears the same ratio to the dividend as the undistributed foreign earnings of the specified 10%-owned foreign corporation bears to the total undistributed earnings of such foreign corporation. Consistent with this, the shareholder will no longer be allowed a foreign tax credit or deduction for any taxes or expenses attributable to the deducted dividend.

- **Mandatory Inclusion of Post-1986 Earnings and Profits.** U.S. shareholders owning at least 10% of a foreign subsidiary generally must include in income, for the subsidiary's last tax year beginning before 2018, the shareholder's pro rata share of the net post-'86 historical E&P of the foreign subsidiary to the extent such E&P has not been previously subject to U.S. tax. These earnings and profits will be subject to a one-time deemed repatriation and taxed at a 15.5 % rate (for cash and cash equivalents) or a reduced 8% rate (for all other earnings and profits, to mitigate the cost of the deemed repatriation of illiquid earnings). U.S. shareholders owning at least 10% of a foreign subsidiary would include their pro rata share of such income. U.S. shareholders may elect to pay the resulting tax liability in installments over eight years. The Act provides a special rule for S corporations. Their shareholders are allowed to elect to maintain deferral on such foreign income until the S corporation changes its status, sells substantially all its assets, ceases to conduct business, or the electing shareholder transfers its S corporation stock.

- **Subpart F Modified.** Controlled foreign corporations and Subpart F are still with us but in an altered state.

  - **Modification of stock attribution rules for determining CFC status.** The Act amends the ownership attribution rules so that certain stock of a foreign corporation owned by a foreign person is attributed to a related US person for purposes of determining whether the related person is a US shareholder of a foreign corporation. Specifically, under prior law, stock in a foreign corporation owned by a foreign person was not treated as constructively owned by a U.S. person. This is no longer the case under the Act. Thus, a U.S. subsidiary of the foreign parent of a multinational group

will be treated as owning stock in a foreign subsidiary of the foreign parent not just prospectively but also retroactively for the last taxable year of foreign corporations beginning before Jan. 1, 2018. This is referred to as "downward attribution." The impact of this attribution needs further clarification.

- **Modification of definition of United States shareholder.** The Act expands the definition of US shareholder in determining whether a foreign corporation is a CFC to include any US person who owns 10% or more of the total value of shares of all classes of stock of a foreign corporation. This provision is effective for the last year of foreign corporations beginning before 2018 and all subsequent years.

- **Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply.** This provision eliminates the requirement that a foreign corporation must be a controlled foreign for an uninterrupted period of 30 days before subpart F inclusions apply. This change could impact certain multinational estate planning techniques utilized for non-US elder generations with US heirs. This change is effective for tax years beginning after 2017.

- **Repeal of Foreign Base Company Oil-Related Income.** For tax years beginning after 2017, the Act eliminates foreign base company oil related income as a category of foreign base company income. Foreign base company income still includes foreign personal holding company income, foreign base company sales income and foreign base company services income.

- **Avoid Base Erosion of US businesses owned by Foreign Persons**. A frequent technique used in inbound tax planning is to require payments from a US business to related parties located in low-tax or no-tax jurisdictions. The Act seeks to reduce these instances of "base erosion" by imposing the Base Erosion Anti-Abuse Tax ("BEAT") on "applicable taxpayers."[12] BEAT is a minimum tax equal to the excess of 10 percent (5% for 2018) of the modified taxable income of the taxpayer (after adding back certain base erosion payments) for the taxable year over an amount equal to the regular tax liability of the taxpayer for the taxable year with certain adjustments. For years beginning after 2025, the 10-percent rate is increased to

[12] An "applicable taxpayer" means with respect to any taxable year, a taxpayer: (A) which is a corporation other than a regulated investment company, a real estate investment trust, or an S corporation; (B) the average annual gross receipts of the corporation for the three-taxable-year period ending with the preceding taxable year are at least $500 million, and (C) the base erosion percentage (as defined above) of the corporation for the taxable year is three percent or higher. The "base erosion percentage" for any tax year is equal to the aggregate amount of base erosion tax benefits of the taxpayer for the tax year divided by the aggregate amount of specified deductions allowable to the taxpayer for the tax year.

12.5%. A base erosion payment generally includes any amount paid or accrued by a US corporation to a related foreign party with respect to which a deduction is allowable.[13] A "related party" for this purpose includes any 25-percent owner of the taxpayer and any other person related to the taxpayer within the meaning of section 482. For these purposes, certain constructive ownership rules apply.

- **Certain Related Party Amounts Paid or Accrued in Hybrid Transactions or with Hybrid Entities.** Certain types of cross border transactions and instruments have had two different characterizations in different jurisdictions**.** BEPS Action 2 (Hybrid Mismatch) would avoid this dual treatment by first denying a US tax deduction for the hybrid payment and if the internal law of the payor's country did in fact allow the deduction, to require the recipient to report such payment as income. Consistent with the purpose of BEPS Action 2, new Section 267A denies a deduction for any "disqualified related party amount" paid or accrued pursuant to a hybrid transaction or by, or to, a hybrid entity. A disqualified related party amount is any interest or royalty paid or accrued to a related party to the extent that: (1) there is no corresponding inclusion to the related party under the tax law of the country of which such related party is a resident for tax purposes or is subject to tax, or (2) such related party is allowed a deduction with respect to such amount under the tax law of such country. A hybrid transaction is any transaction, series of transactions, agreement, or instrument one or more payments with respect to which are treated as interest or royalties for US Federal income tax purposes and which are not so treated for purposes of the tax law of the foreign country of which the recipient of such payment is resident for tax purposes or is subject to tax. A hybrid entity is any entity which is either: (1) treated as fiscally transparent for Federal income tax purposes but not so treated for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax, or (2) treated as fiscally transparent for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax but not so treated for Federal income tax purposes. Section 267A further provides that the Secretary of the Treasury has broad authority to issue regulations to carry out the purposes of this provision.

  This provision is similar to, but does not appear to be as extensive as, BEPS Action 2 which does not limit its application to related party payments. See Example 1.31 in the OECD's Final Report for Action 2 (2015).

- **Global Intangible Low-Taxed Income.** As noted above under "Territorial Tax System," the Act generally exempts from US tax foreign income earned by a U.S. corporation through a foreign subsidiary by way of the DRD. In order to reduce instances where US taxpayers seek to shift profits from intangibles to offshore jurisdictions and thereby benefit further from this new participation exemption, the

[13] Such payments also include any amount paid or accrued by a domestic corporation to its related party in connection with the acquisition by the taxpayer from the related party of property of a character subject to the depreciation or amortization. Base erosion payments do not include payments for the cost of goods sold.

Act imposes a tax on foreign-source intangible income. Therefore, for taxable years of foreign corporations beginning after 2017, and for taxable years of U.S. shareholders in which or with which such years of foreign corporations end, a U.S. shareholder of any CFC must include in gross income its global intangible low-taxed income ("GILTI") in a manner generally similar to inclusions of subpart F income. Under the Act, US shareholders must include in income currently their shares of each on their CFC's profits to the extent they exceed 10% of each CFC's return on its tangible assets. In general, GILTI includes all net operating income of a foreign corporation not otherwise taxed to U.S. shareholders (excluding generally other income currently taxed to the shareholder (such as Subpart F income and effectively connected income) in excess of 10 percent of the aggregate of its adjusted bases in specified tangible property used in its trade or business for which a deduction is allowable under section 168. For tax years that begin after 2017 and before 2026, 50% of any GILTI amount which is included in the gross income of the domestic corporation (but not a RIC or REIT) under Code Sec. 951A for the tax year is deductible by a C corporation. Thus, in the case of a private equity fund organized as a partnership, such deduction will not be allowed if the partnership's income flows through to a shareholder that is not a C corporation. For years that begin after 2025, the deduction will be reduced to 37.5% of the GILTI amount included in the gross income of the domestic corporation for the tax year. Another advantage for a C corporation is that such taxpayers are allowed a deemed paid foreign tax credit for 80% of the foreign taxes attributable to the GILTI inclusion.

- **Deductions for Foreign-Derived Intangible Income.** The Act provides a reduced effective tax rate for income derived by US corporations which sell into non-US markets. This reduced effective tax rate applies to "foreign derived intangibles income" (FDII). FDII is essentially all of a US corporation's income derived from property sold, leased or licensed by a US corporation to any person that is not a US person, in excess of the "deemed tangible income return". "Deemed tangible income return" means, with respect to any corporation, an amount equal to 10 percent of the corporation's qualified business asset investment on the tangible assets used in generating such income.[14] A domestic corporation is allowed a deduction in an amount equal to 37.5% of the foreign-derived intangible income (FDII) of the domestic corporation for the tax year. For tax years that begin after 2025, the allowed deduction will decreased to 21.875% of the FDII of the domestic corporation for the tax year. The effect of these deductions is that a US corporation will be taxed at a 13.1% rate on its FDII in 2018 through 2025 and 16.4% thereafter.

- **Fair market value method of interest expense allocation or apportionment repealed.** It is necessary to determine income both from U.S. sources and income from foreign sources for a number of different tax purposes. In doing so, it is necessary to either allocate or apportion various expenses including interest

[14] For purposes of computing its FDII, a domestic corporation's QBAI is the average of the aggregate of its adjusted bases, determined as of the close of each quarter of the taxable year, in specified tangible property used in its trade or business and of a type with respect to which a deduction is allowable under section 167.

expense between income from U.S. sources and income from foreign sources. Under pre-Act law allocation and apportionment of interest expense had to be allocated or apportioned on the basis of assets rather than gross income. The Regulations allowed taxpayers to determine the value of their assets either on the basis of the tax book value or the fair market value of their assets. The tax book value was generally the asset's adjusted basis for U.S. tax purposes. Under the fair market method, a taxpayer had to establish the fair market value of its assets to the satisfaction of IRS. Under the Act, allocations and apportionments of interest expense must be determined using the adjusted bases of the assets rather than the fair market value of the assets or gross income. This provision was enacted because under the Act, taxpayers may expense the cost of qualified property as Bonus Depreciation. Thus, the U.S. assets will often have a fair market value that is greater than their tax book value. The repeal of the fair market value alternative, will, therefore, tend to reduce the amount of interest allocated to net income from U.S. sources.

TAX REFORM FOR INDIVIDUALS

Changes made by the Act which impact individuals include:

- **Rates.** Subject to the discussion above on the "20% deduction for qualifying business income ("QBI")", for years beginning after 2017 and before 2026, the following seven tax rates apply for individuals: 10%, 12%, 22%, 24%, 32%, 35%, and 37% and the following apply for estates and trusts: 10%, 24%, 35%, and 37%.

- **AMT.** The AMT has been retained. However, the exemption amounts have been increased. For tax years beginning after 2017 and before 2026, the exemption amounts will be $109,400 for joint and surviving spouse returns and $70,300 for returns of single taxpayers and $54,700 for marrieds filing separately. For trusts and estates, the base figure of $22,500 remain unchanged. These amounts will be adjusted for inflation after 2018 under the new C-CPI-U inflation measure.

- **Suspension of overall limitation on itemized deductions.** Before the Act, the otherwise allowable total amount of itemized deductions was reduced by 3 percent of the amount by which the taxpayer's adjusted gross income exceeded a threshold amount. Under the Act, the overall limitation on itemized deductions has been suspended for years after 2017 through 2025.

- **Deduction for Home Mortgage Interest.** For tax years beginning after 2017 and before 2026, the deduction for interest on home equity indebtedness is suspended, and the deduction for mortgage interest is limited to underlying indebtedness of up to $750,000 ($375,000 for married taxpayers filing separately). The Act's reduced limitation on acquisition indebtedness doesn't apply to any indebtedness incurred

on or before Dec. 15, 2017 where the limitation continues to be $1,000,000 ($500,000 for marrieds filing separately).

- **State and Local Taxes.** For tax years beginning after 2017 and before 2026, subject to the exception described below, State and local property taxes, and State and local sales taxes, are deductible only when paid or accrued in carrying on a trade or business or an activity for the production of income. State and local income, war profits, and excess profits are not allowable as a deduction. However, a taxpayer may claim an itemized deduction of up to $10,000 ($5,000 for a married taxpayer filing a separate return) for the *aggregate* of (i) State and local property taxes *not* paid or accrued in carrying on a trade or business or activity for the production of income; and (ii) State and local income, war profits, and excess profits taxes (or sales taxes in lieu of income, etc. taxes) paid or accrued in the tax year.

- **Increase in Standard Deduction.** For years after 2017 and before 2026 the Act increases the standard deduction to $24,000 for joint filers (and surviving spouses) and $12,000 for singles and marrieds filing separately. Heads of household could claim a standard deduction of $18,000. These amounts would be adjusted for inflation based on chained CPI.

- **Personal Exemptions.** For tax years beginning after 2017 and before 2026 the deduction for personal exemptions is effectively suspended by reducing the exemption amount to zero.

- **Estate and Generation-Skipping Transfer Taxes.** For estates of decedents dying and gifts made after 2017 and before 2026, the Act doubles the base estate and gift tax amount from $5.49 million in 2017 million to approximately $11.2 million in 2018, which amount is indexed for inflation going forward on an annual basis. The language in the Act does not mention generation-skipping transfers, but because the generation-skipping transfer tax exemption amount is based on the basic exclusion amount, generation-skipping transfers should also see an increased exclusion amount. However, the increase in the Federal gift and estate tax exemption does not necessarily impact State estate tax exemptions. Therefore, an estate may escape Federal estate tax, but be subject to State estate tax (for example, New York continues to have an exemption based on $5 million indexed annually for inflation).

OTHER PROVISIONS

- **Tax Exempt Organizations.** The Act (i) adds an excise tax that is imposed on compensation in excess of $1 million paid by an exempt organization to a "covered" employee, (i) imposes an excise tax on the net investment income of colleges and universities meeting specified size and asset requirements, (iii) requires gains and losses to be calculated and applied to each unrelated trade or business separately,

and (iv) an exempt organization's unrelated business taxable income (UBTI) is to include any nondeductible entertainment expenses, and costs incurred for any qualified transportation fringe, parking facility used in connection with qualified parking, or any on-premises athletic facility.

- **Adjustments for Inflation.** The Act requires the use of the C-CPI-U to index the tax parameters under the Code that are currently indexed by the CPI-U. C-CPI-U is a slower growing method of calculating COLAs than CPI-U.

- **Like-Kind Exchange Restriction.** The Act limits the use of "like-kind exchanges" to exchanges of real property.

- **Alimony.** For any divorce or separation agreement executed after Dec. 31, 2018, or executed before that date but modified after it (if the modification expressly provides that the Act's amendments apply), alimony and separate maintenance payments are not deductible by the payor spouse and are not included in the income of the payee spouse.

- **Repeal of deduction for personal casualty losses.** For tax years beginning after 2017 and before 2026, the personal casualty and theft loss deduction is suspended, except for personal casualty losses incurred in a Federally-declared disaster zone.

PLANNING OBSERVATIONS

- Private equity funds and their investors could be greatly impacted by the new limitation on the deductibility of business interest and the 20% deduction with respect to qualified business income for pass-through businesses. Also, the impact of the BEAT and GILTI provisions in cases where funds make cross-border acquisitions must be taken into account. For example, the GILTI provisions could apply to a domestic fund holding 10% or more (by vote or value) of the stock of a foreign corporation if it and other U.S. persons (also holding 10% or more of such stock) hold more than 50% of the stock of such foreign corporation. The domestic limited partnership structure often used may result in the partners being subject to the GILTI tax and, unless a C Corporation blocker is inserted, the deduction afforded by the new law would not be available.

- Consider state and local income taxes. Remember that the ban on deductibility of such taxes does not apply to C corporations. Cases may exist where the difference in after-tax income between C corporation shareholders and pass-through owners might not be as significant than if one just looks at federal rates.

- While the Act does not specifically modify the US transfer pricing rules, the expectation is that the transfer pricing policies of most multinational enterprises with a significant US presence will need to be reviewed given the significant

decrease in the US corporate tax rate along with the GILTI, FDII and BEAT rules.

- In structuring taxable M&A transactions for purchasers, consideration should be given to negotiating to purchase assets rather than shares if assets being acquired consist of tangible personal property eligible for bonus depreciation. This form of acquisition may permit immediate expensing of the purchase price allocated to these assets.

Please call or email your contact at Barton LLP or the author of this Alert, Jim Guadiana (JGuadiana@bartonesq.com or 212 885 8837), if you should you have any questions or need further clarification of the Act's provisions.