

2018 Post-Filing Season Update

APRIL 26, 2018

Highlights

- ✓ Tax Day E-Filing Glitch
- ✓ TCJA Guidance
- ✓ New 2018 Inflation Adjustments
- ✓ Tax Extenders and Technical Corrections
- ✓ Partnership Audit Rules

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SPECIAL REPORT

Filing Season Developments

The 2018 individual tax filing season has come to an end. Other than an IRS electronic processing system glitch on Tax Day, which led to the extension of the filing deadline to midnight on April 18, Acting IRS Commissioner David Kautter reported to Congress on April 17 that the 2018 tax filing season had gone smoothly. The IRS reported no major breaches of its primary systems by cybercriminals. Congress and the White House continue tax reform discussions as Republican leaders gear up for a “second phase.”

This Briefing highlights some of the key developments during the filing season that will impact taxpayers of all types for the rest of 2018.

IRS TAX DAY GLITCH

For over eight hours on April 17, taxpayers were reportedly unable to make payments on the IRS’s Direct Pay platform or file returns electronically. The IRS experienced a computer mainframe system glitch, which caused an unexpected hiccup on the last day of what the IRS had previously said had been a smooth filing season. Kautter told House lawmakers in a House Oversight Subcommittee hearing on April 17, while the glitch was occurring, that taxpayers would not be penalized for the technical difficulties.

According to the IRS, the Service’s systems were functioning properly by 9a.m. EST on April 18.

“This is the busiest tax day of the year, and the IRS apologizes for the inconvenience this system issue caused for taxpayers,” Kautter said in an April 17 news release. “The IRS appreciates everyone’s patience during this period. The extra time will help taxpayers affected by this situation.”

TAX REFORM


Tax reform proposals continued to grab headlines during the filing season, as both the White House and Republican lawmakers discussed a “second phase” of tax reform. House Ways and Means Committee Communications Director Julia Slingsby told Wolters Kluwer that Chairman Kevin Brady, R-Tex., wants to see more frequent fixes to the tax code. “The Chairman believes we need to change this culture in Washington where we only fix the tax code once every generation. Phase two is taking a look at things that we can do even better — encouraging more innovation, making America more competitive, and specifically helping families flourish by making the individual tax reforms permanent,” Slingsby told Wolters Kluwer.



A phase two of tax reform would likely include making permanent full expensing for business investments and individual tax cuts, which are currently temporary provisions under the law, according to President Trump's top economic advisor. However, tax policy observers, including former Treasury deputy assistant secretary for tax policy Dana Trier, have said a major tax bill this year is unlikely.

“The Chairman believes we need to change this culture in Washington where we only fix the tax code once every generation.”

*— House W&M Committee Communications
Director Julia Slingsby*

 **COMMENT.** Any new tax legislation introduced without a budget resolution as a legislative vehicle would need Democratic support. Under the Senate's reconciliation process a budget resolution allowed a simple GOP majority to approve the Tax Cuts and Jobs Act (TCJA).

With the enactment of the TCJA last December, the IRS has already begun issuing guidance to implement certain tax changes under the new law. Although the IRS Tax-Exempt and Government Entities Division Commissioner Sunita Lough, currently serving as the director of the IRS's Tax Reform Implementation Office (TRIO), told Congress that the IRS hopes to issue most TCJA-related guidance by next year's filing season, Kautter has told Congress he expects it to take the IRS “a couple of years” to complete the task.

Since the first of the year, the IRS has issued the following key pieces of guidance related to tax reform:

Tax rate for fiscal year corporations. Many U.S. corporations elect to use a fiscal year for federal income tax reporting purposes. Pursuant to the TCJA, a corporation with a fiscal year that includes January 1, 2018, will pay federal income tax using a blended tax rate, not the flat 21 percent tax rate under the TCJA that would generally apply to tax years beginning after December 31, 2017 (*Notice 2018-38*). Corporations determine their federal income tax for fiscal years that include January 1, 2018, by first calculating their tax for the entire tax year using the graduated tax rates in effect prior to TCJA and then calculating their tax using

the new 21-percent rate, subsequently proportioning each tax amount based on the number of days in the tax year when the different rates were in effect. The sum of these two amounts is the corporation's federal income tax for the fiscal year.

Transition tax. The IRS provided updated answers to frequently asked questions (FAQs) about filing 2017 returns and making tax payments and elections relating to the transition tax (*Questions and Answers about Reporting Related to Section 965 on 2017 Tax Returns, April 15, 2018*). The instructions in the FAQs are for filing 2017 tax returns with an amount required by Code Sec. 965. The updated FAQs cover what elections are available; instructions on making those elections; reporting additional information to shareholders, partners and beneficiaries; how to pay the tax resulting from a Code Sec. 965 inclusion; estimated payments; and refunds, among other subjects. For each election, a statement must be attached to the return and signed under the penalties of perjury, and in the case of an electronically filed return, attached in .pdf format. In addition, any tax must be paid in two separate payments. One payment will reflect the tax owed, without Code Sec. 965. The second payment is the Code Sec. 965 payment. Both payments must be made by the due date of the applicable return (without extensions). Additional details for paying the tax are provided in the FAQs.

Treasury and the IRS also provided guidance on computing the “transition tax” on the untaxed foreign earnings of foreign subsidiaries of U.S. companies under the TCJA (*Notice 2018-26*). This guidance covers anti-avoidance rules, rules for special elections, reporting and paying the transition tax, and relief from estimated tax penalties. The guidance also addresses additional issues under the transition tax, including the constructive ownership rules that allow for the downward attribution of stock from a partnership to a partner, the determination of cash measurement dates and the treatment of accrued foreign income taxes for purposes of determining post-1986 earnings and profits. The Treasury and IRS intend to issue regulations reflecting the guidance and the guidance may be relied upon until the regulations are issued.

The IRS announced that it will not approve a request to change an accounting period under either the existing automatic or general change of accounting period procedures if the change could result in the avoidance, reduction, or delay of the transition tax (*IR-2018-25*). This guidance applies to any request to change an annual accounting period that ends on December 31, 2017, regardless of when the request was filed.

COMMENT. Before this guidance, a specified foreign corporation with a tax year ending on December 31, 2017, could have avoided Code Sec. 965 by changing its tax year. If a calendar-year deferred foreign income corporation (DFIC) changed to a tax year closing on November 30, effective for its tax year beginning January 1, 2017, the election could defer by as much as 11 months a U.S. shareholder's inclusion with respect to the DFIC. The election could also reduce the tax liability of a U.S. shareholder of the DFIC by reducing the DFIC's post-1986 earnings and profits.

Treasury and the IRS issued reliance guidance on computing the transition tax under the TCJA (*Notice 2018-7*). In addition, the IRS announced that any regulations will include rules for determining the amount of cash and cash equivalents for purposes of applying the 15.5 percent rate. The regulations will also include rules for determining the amount of foreign earnings subject to the transition tax.

Calculation of earnings and profits. Treasury and the IRS provided an alternative method for calculating post-1986 earnings and profits (E&P) (*Notice 2018-13*). According to the guidance, the specified foreign corporation's actual post-1986 E&P must be determined as of the close of both November 2, 2017, and December 31, 2017. However, it is impractical for some taxpayers to determine post-1986 E&P on a date other than the last day of the month. Therefore, the regulations will provide an election to use an alternative method for determining post-1986 E&P. The notice provides examples of the alternative method. In addition, this notice provides guidance on the repeal of Code Sec. 958(b)(4).

Business interest expense limitation. Treasury and the IRS provided guidance for computing the business interest expense limitation under the TCJA (*Notice 2018-28*). The deduction is generally limited to any interest income, plus 30 percent of the taxpayer's adjusted taxable income. The new limitation applies to all taxpayers.

Withholding on transfers of partnership interests. Treasury and the IRS issued guidance regarding withholding on the transfer of nonpublicly traded partnership interests under the TCJA (*Notice 2018-29*). New Code Sec. 1446(f) requires a transferee to withhold 10 percent of the amount realized on the disposition of a partnership interest by a nonresident alien individual or a foreign corporation when any portion of the gain would be treated as effectively connected with the conduct of a U.S. trade or business under new Code Sec. 864(c)(8). In general, Code Sec. 864(c)(8) applies

2018 Key Tax Development Snapshots



New 2018 Inflation-Adjusted Amounts

The Tax Cuts and Jobs Act necessitated changes to previously released 2018 inflation-adjusted amounts, either due to a statutory change (or elimination) of the amount or the shift to chained consumer price index. Some notable changes are below.

Adjusted Item	Prior Law	TCJA
Personal Exemption		
	\$4,150	\$0
Standard Deduction		
Joint and surviving spouses	\$13,000	\$24,000
Head of household	\$9,550	\$18,000
Single, separate filers	\$6,500	\$12,000
Earned Income Credit		
3+ children	\$6,444	\$6,431
2 children	\$5,728	\$5,716
1 child	\$3,468	\$3,461
No children	\$520	\$519
Phaseout begins w/ kids	\$18,700	\$18,660
w/o kids	\$8,510	\$8,490
Foreign Earned Income Exclusion		
	\$104,100	\$103,900
Code Sec. 179 Deduction		
Amount deductible	\$520,000	\$1,000,000
Max placed in service	\$2,070,000	\$2,500,000

to sales, exchanges, or other dispositions occurring on or after November 27, 2017, but withholding under Code Sec. 1446(f) applies to sales, exchanges, and dispositions after December 31, 2017.

Carried interests. The IRS announced plans to issue regulations clarifying the new three-year holding period for certain carried interests (*IR-2018-37*). The new regulations will provide that partnership interests held by S corporations are subject to the extended three-year holding period for applicable partnership interests imposed by new Code Sec. 1061.

Withholding. The IRS released an updated Withholding Calculator on IRS.gov and a new version of Form W-4 (*IR-2018-36*). The new withholding calculator will let employees check that their income tax withholding is proper following passage of the TCJA. The IRS also issued updated income-tax withholding tables for 2018 to reflect changes made by the TCJA (*Notice 1036*).

New Forms. The IRS has said that implementation of tax reform will require it to create or revise approximately 450 forms, publications, and instructions, as well as modify about 140 information technology systems associated with tax return processing and compliance activities.

OMB OVERSIGHT OF CERTAIN TAX REGULATIONS

Certain proposed regulations issued by Treasury will now be subject to additional oversight by the Office of Management and Budget (OMB). A Memorandum of Agreement (MOA) between Treasury and OMB released on April 12 specifies the terms under which the Office of Information and Regulatory Affairs (OIRA) within OMB will review future tax regulations.

The MOA comes on the heels of recent debate on whether OMB should have increased oversight of Treasury's tax-related regulations. While some lawmakers have argued for additional oversight of tax rules, others have expressed concern that more oversight will lead to delays in issuing guidance. The subject has been of particular focus on Capitol Hill as Treasury and the IRS prepare to implement the TCJA.

A previous agreement adopted in 1983 and reaffirmed in 1993, allowed for OIRA review of some regulations but exempted most tax rules. "The MOA announced today replaces the 1983 agreement with a new review process tailored to tax regulations—it focuses on reducing regulatory burdens while providing timely guidance to taxpayers," according to a news release from Treasury. Treasury Secretary Steven Mnuchin and OMB Director Mick Mulvaney both praised the MOA in a joint news release for ensuring clarity and transparency for taxpayers.


Generally, OIRA will have 45 days to review submissions from Treasury, according to the MOA. However, to allow for timely implementation of the TCJA, the Treasury secretary or deputy secretary, with the approval of the OIRA administrator, may designate certain tax rules for expedited release.


IMPACT. *Under the terms of the MOA, tax rules will be subject to OIRA review if they interfere with an action taken by another agency, raise novel legal or policy issues, or have an annual nonrevenue effect on the economy of \$100 million or more.*

COMMENT. *"There may be perfectly good reasons for adding an additional layer of review to finalize Treasury regulations," John Gimigliano, principal-in-charge of federal legislative and regulatory services in the Washington National Tax practice of KPMG LLP, told Wolters Kluwer. "But speeding up implementation of the new tax law is not one of them. The practical effect of this is that taxpayers will have to wait longer for Treasury to issue interpretations of the new law."*

TAX EXTENDERS

President Trump on February 9 signed the Bipartisan Budget Act of 2018 (BBA), which contains more than a handful of tax provisions, including disaster tax relief and the extension of over 30 expired tax breaks. Most of the tax relief included in the legislation applies for the 2017 tax year only.

 **COMMENT.** *While many economists and lawmakers argue retroactive tax extenders are unfavorable tax policy, others contend that these tax breaks were included in the BBA because they had been relied upon and expected for the 2017 tax year but were left to expire amid diverted efforts to focus on the tax code overhaul within the TCJA. A House Ways and Means Committee spokesperson told Wolters Kluwer that “[j]ob creators and families expected these extenders-in a pre-tax reform world-would be taken care of in a similar fashion, as Congress has done for years.”*

 **COMMENT.** *Both Republican and Democratic lawmakers have varying views on specific temporary tax provisions, but in general, seem to have largely been in agreement that year-end tax extenders are not good policy. New to the discussion, however, is whether such provisions are worthwhile now that business tax rates have been lowered along with full and immediate expensing under the TCJA. The House Ways and Means Committee is continuing to examine tax extenders’ place and relevancy post-tax reform.*

The following provisions are extended through 2017 unless otherwise noted:

- exclusion from gross income of discharge of qualified principal residence indebtedness;
- mortgage insurance premiums treated as qualified residence interest;
- above the line deduction for qualified tuition and related expenses;
- Indian employment tax credit;
- railroad track maintenance credit;
- mine rescue team training credit;
- classification of certain race horses as three-year property;
- seven-year recovery period for motorsports entertainment complexes;
- accelerated depreciation for business property on an Indian reservation;
- election to expense mine safety equipment;
- special expensing rules for certain productions;
- deduction allowable with respect to income attributable to domestic production activities in Puerto Rico;
- special rule relating to qualified timber gain;
- empowerment zone tax incentives;
- American Samoa economic development credit;
- nonbusiness energy property credit;
- nonresidential energy property credit (extended through 2021 and modified);
- new qualified fuel cell motor vehicles credit;
- credit for alternative fuel vehicle refueling property;
- credit for 2-wheeled plug-in electric vehicles;
- second generation biofuel producer credit;
- biodiesel and renewable diesel incentives;
- production of credit for Indian coal facilities (extended to a 12-year period);
- credits with respect to facilities producing energy from certain renewable resources;
- credit for energy-efficient new homes;
- energy credit (extended through 2021 and modified);
- special allowance for second generation biofuel plant property;
- energy efficient commercial buildings deduction;
- special rule for sales or dispositions to implement FERC or state electric restructuring policy for qualified electric utilities;
- excise tax credits relating to alternative fuels;
- oil spill liability trust fund financing rate;
- temporary increase in limit on cover over rum excise taxes to Puerto Rico and the Virgin Islands;
- waiver of limitations with respect to excluding from gross income amounts received by wrongfully incarcerated individuals (extended through December 18, 2018); and
- carbon dioxide sequestration credit (enhanced, modified and generally extended through 2023).

DISASTER RELIEF

The BBA also established disaster tax relief for individuals and businesses impacted by California wildfires. Such relief includes allowing access to retirement funds, suspending the limit on charitable contribution deductions, allowing deductions for personal casualty disaster losses and a tax credit for employee retention. In addition, tax relief was extended for areas affected by hurricanes Harvey, Irma and Maria.

Other provisions included modifications to:

- the rules relating to whistleblower awards,
- the Opportunity Zone rules for Puerto Rico,
- user fees on installment agreements, and
- hardship distributions and withdrawals from deferred accounts.

In addition, the BBA requires the creation of a new version of Form 1040, specifically for seniors, for tax years beginning after February 9, 2018 (the 2019 tax year for calendar year taxpayers). Also, the BBA clarified the excise tax on investment income of private colleges and universities. The tax is calculated based on 500 “tuition-paying” students. This requirement was included in the original version of the Tax Cuts and Jobs Act, but was removed at the last minute to comply with budget reconciliation rules.

“Proposed IRS reform bills aim to restructure the IRS for the first time in 20 years.”

PARTNERSHIP AUDIT REGIME

The Consolidated Appropriations Act, 2018 (CAA) was signed by President Trump on March 23. The omnibus spending package, which provides funding for the government and federal agencies through September 30, contains several tax provisions, including technical corrections to the partnership audit provisions of the Bipartisan Budget Act of 2015.

The CAA clarifies the scope of the partnership audit rules. The CAA eliminated references to adjustments to partnership income, gain, loss, deduction, or credit and replaced them with partnership-related items. “Partnership-related items” are any items or amounts that are relevant to determining the income tax liability of any partner, according to the Joint Committee on Taxation (JCT). Among other things, partnership-related items include an imputed underpayment or an item or amount relating to any transaction with, basis in, or liability of the partnership.

According to the JCT, the partnership audit rules do not apply to withholding taxes except as specifically provided. However, any partnership income tax adjustment will be considered when determining and assessing withholding taxes when the partnership adjustment is relevant to that determination. Further, the technical corrections clarify that an imputed partnership underpayment is determined

by appropriately netting partnership adjustments for that year, and then applying the highest rate of tax for the reviewed year.

Also included in the CAA is a “pull-in” procedure, which allows for modifying an imputed underpayment without requiring individual partners to file an amended tax return. The “pull-in” procedure, if elected, replaces the push-out approach. A push-out shifts liability to individual partners. The “pull-in” procedure contemplates that partner payments and information could be collected centrally by the partnership or the IRS.

The CAA also changes the partnership e-filing requirements, phasing in a lower threshold over five years. Partnerships must efile returns if the partnership is required to file at least 200 returns for calendar year 2018, 150 returns for calendar year 2019, 100 returns for calendar year 2020, 50 returns for calendar year 2021, and 20 returns for calendar years after 2021.

IRS REFORM

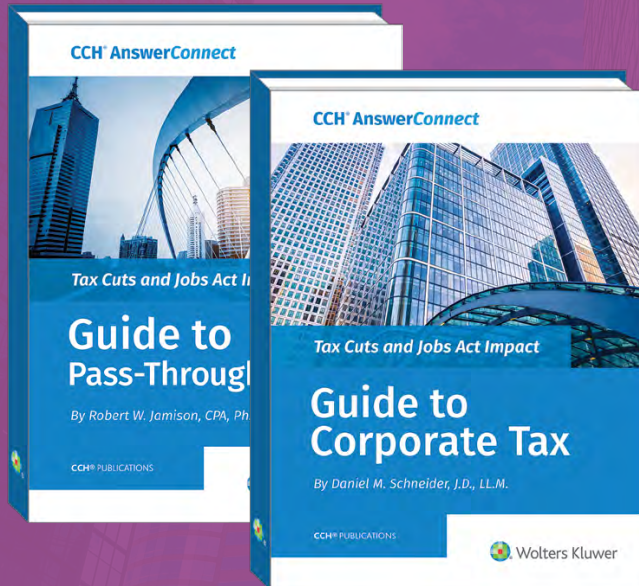
The House on April 18 approved the two largest bills of a bipartisan IRS reform package. The bills aim to restructure the IRS for the first time in 20 years. The 21st Century IRS Bill (HR 5445) was approved 414-to-0. The Taxpayer First Bill (HR 5444) passed by a 414-to-3 vote. The lead bipartisan reform package bill, HR 5444, proposes changes to the IRS’s appeals process and customer service programs. Also, it implements other organizational changes. HR 5445 focuses primarily on cybersecurity safeguards.

The House approved seven bills by unanimous consent the day before on April 17 that are also part of the bipartisan IRS reform package. Those House-approved bills (HR 2901, HR 5440, HR 5438, HR 5446, HR 5437, HR 5439, and HR 5443) include proposals to establish a single point of contact for tax-related identity theft victims, expand the use of Low-Income Taxpayer Clinics (LITCs), and require electronic filing for certain tax-exempt organizations, among other things.

How the IRS reform bills will fare in the Senate remains to be seen. Although Senate Finance Committee (SFC) Chairman Orrin G. Hatch, R-Utah has commended the House’s efforts toward restructuring the IRS, no official notice has been released as for when the Senate will consider the measures.

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