WASHINGTON TAX NEWS

Potomac Law Tax Newsletter— September 2018 **Susan Rogers**

Congressional activity slowed in the month of August with both the House and Senate taking a recess, although the Senate recess was shortened to one week. **Key legislative issues, including the FY 2019 appropriations bills, must be dealt with this month,** but the **upcoming mid-term elections** will be the primary focus in Washington this fall with the possibility that Republicans could lose the majority in one or both chambers.

The House returned to work after Labor Day and is scheduled to work for 11 legislative days in September and two weeks in October before adjourning to return home for the mid-term elections. The Senate is scheduled to be in session for most of October, which keeps incumbents off the campaign trail. The key **priority will be to pass a spending bill that prevents a government shutdown** on October 1st. The Senate has passed an $857 billion spending bill, but there are key differences between the House and Senate bills that must be resolved, while the President has threatened a government shutdown if the bill does not include funding for a border wall.

With the possibility that **Democrats** may gain control of the House, there has been speculation about **what action might then be taken to reverse some of the changes in the Tax Cuts and Jobs Act (TCJA)**. Priority topics are likely to include increasing the corporate tax rate and changing the treatment of capital gains and carried interest. There is more uncertainty about what action might be taken on the new cap on state and local tax deductions and the section 199A pass-through deduction.

For more information on these issues, please contact Susan Rogers at srogers@potomaclaw.com or 202.492.3593.

The House Ways & Means Committee scheduled a markup of Tax Reform 2.0 to include legislation that would make permanent the individual and small business provisions of the Tax Cuts and Jobs Act, provide new incentives to promote retirement and "family savings," and encourage the formation of new businesses.

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TAX REFORM UPDATE — Tax Reform 2.0

House Ways & Means Committee Chairman Brady (R-TX) scheduled for September 13th a **markup of Tax Reform 2.0** with legislation that would make permanent the individual and small business provisions of the TCJA (which are scheduled to expire in 2025), provide new incentives to promote retirement and "family savings," and encourage the formation of new businesses through the American Innovation Act, which would simplify and expand the deduction for start-up and organizational costs and preserve start-up net operating losses and tax credits through an ownership change.

The Joint Tax Committee has estimated that these three bills would reduce federal revenue by about $657 billion over 10 years with the tax cut legislation losing $631 billion. The markup is also scheduled to include legislation that would make several **changes to the Affordable Care Act** including a delay of the employer mandate and the Cadillac tax.

House Speaker Paul Ryan (R-WI) has stated that the **full House will vote on these bills** later in September. A **spokesman for SFC Chairman Hatch** (R-UT) has said that he supports making the individual tax cuts from the 2017 law permanent, and he will continue to work with his colleagues to find a "viable path and timing to achieve this goal."

It is **unlikely that such legislation would move in the Senate prior to the mid-term elections,** but Congressional Republicans see some advantages in voting now on these issues to provide talking points ahead of the November elections. Approval in the Senate would require 60 votes to overcome procedural hurdles, because Republicans have not passed a joint FY 2019 budget resolution with reconciliation instructions that would allow for passage of tax legislation with a simple majority.

***South Dakota v. Wayfair* – Online Sales Taxation**

While the House was in recess, Congress took no further action in response to the Supreme Court decision in *Wayfair*. **Individual states continue to** respond to the decision with reports that 24 out of the 45 states with a sales tax are in various stages of requiring out-of-state retailers to collect taxes. Some states have started to enforce rules they already had in place (including Massachusetts), others have issued administrative guidance (including Alabama, Hawaii, Iowa, North Dakota, and Rhode Island), while others have announced that they will take action (including Utah, South Carolina, and Wisconsin). Other states working on responses include Maryland, Texas, and Louisiana.

The state of New Hampshire, which does not have a sale tax, has reacted differently by focusing its efforts on protecting New Hampshire businesses from having to collect sales tax in other states although an initial piece of legislation failed to gain approval in both the NH House and Senate, so work continues on a bill that will more effectively protect New Hampshire businesses. An unofficial draft of legislation circulating in California would require out-of-state retailers with $500,000 of annual sales into the state to collect and remit sales and use tax and includes a provision that the legislation would not apply retroactively.

Treasury and the IRS

The Senate Finance Committee has now approved the **nominations of Charles Rettig to be IRS Commissioner, Michael Desmond as Chief Counsel for the IRS, and Justin Muzinick as Deputy Secretary of the Treasury.** Policy disputes between Democrats and Republicans in the Senate, however, were holding up confirmation by the full Senate of all three men with objections lodged by SFC Ranking Member Ron Wyden (D-OR) and Senator Bob Menendez (D-NJ). Senate Majority Leader McConnell (R-KY) filed cloture on the nomination of Rettig, and the full Senate approved his nomination.

Treasury and the IRS

The IRS issued final regulations on **automatic and non-automatic filing extensions for certain information returns**. The goal of the changes is to accelerate the filing of the Form W-2 series (except Form W-2G) and forms that report nonemployee compensation (currently Form 1099-MISC with information in box 7) so they are available earlier in the filing season for use in the IRS's identity theft and refund fraud detection processes.

Treasury and the IRS have withdrawn and reproposed certain portions of proposed regulations implementing the **centralized partnership audit regime** to reflect changes made by the Technical Corrections Act of 2018.

The IRS issued final regulations on the **substantiation and reporting requirements for cash and noncash charitable contributions** for: contributions greater than $500; the new definitions of qualified appraisal and qualified appraiser for noncash contributions; and recordkeeping requirements for all cash contributions.

TCJA Guidance

Passthrough Deduction rules: Treasury and the IRS issued a notice of proposed rulemaking including **proposed regulations concerning the deduction for qualified business income under Code section 199A**. The proposed rules are intended to provide taxpayers with computational, definitional, and anti-avoidance guidance regarding the application of Code section 199A. Code section 199A provides for a deduction of up to 20% of qualified business income (QBI) from a domestic business operated as a sole proprietorship, partnership, or S corporation and applies to taxable years beginning after 2017 and before 2026. The deduction is not available for wage income or for business income earned through a C corporation.

The proposed rules provide **guidance on the following key topics**: (1) definition of trade or business; (2) aggregation rules; (3) the definitions of a specified service trade or business (SSTB) and the trade or business of performing services as an employee; (4) rules for calculating QBI, qualified REIT dividends, and qualified publicly traded partnership (PTP) income; (5) operational rules; (6) the wage and basis limitation; and (7) rules for passthrough entities.

Treasury and the IRS also issued **Notice 2018-64**, which provides a proposed revenue procedure providing methods for calculating W-2 wages (1) for purposes of Code section 199A(b)(2), which, for certain taxpayers, provides a limitation based on W-2 wages to the amount of the deduction for QBI under Code section 199A(a); and (2) for purposes of Code section 199A(b)(7), which, for certain specified agricultural and horticultural cooperative patrons, provides a reduction to the Code section 199A(a) deduction based on W-2 wages.

State and Local Tax Deduction: The IRS issued proposed **regulations intended to block moves by some states to offset the loss of state and local tax deductions** resulting from changes enacted in the TCJA. The new guidance sets forth rules for charitable contribution deductions when a taxpayer gets a corresponding state or local tax credit. The proposed rules "generally provide that if a taxpayer makes a payment or transfers property to or for the use of an entity listed in section 170(c), and the taxpayer receives or expects to receive a state or local tax credit in return for such payment, the tax credit constitutes a return benefit, or quid pro quo, to the taxpayer and reduces the charitable contribution deduction." Exceptions are provided for dollar-for-dollar state tax deductions and for tax credits up to 15 percent of the payment amount, or of the fair market value of property transferred. The rules are proposed to take effect on August 27, 2018, and a public hearing is scheduled for November 5, 2018. Ways & Means Committee Chairman Brady (R-TX) issued a statement endorsing the IRS guidance noting that the rules "rightly close the door on improper tax evasion schemes conjured up by state and local politicians … At the same time, Treasury is clearly seeking to preserve important state tax credit programs that were in place before tax reform that are genuinely designed to serve local charities, many of them educational."

The States of **Connecticut, Maryland, New Jersey, and New York have filed suit** in federal court claiming that Republicans purposely targeted "blue states" by capping the state and local tax deduction. Republicans have indicated that a permanent extension of the state and local tax deduction cap is likely to be included in a Tax Reform 2.0 package, but this could prove to be problematic as several Republicans from the states affected are opposed to the cap.

Bonus Depreciation: Treasury and the IRS released proposed regulations that provide **guidance regarding the additional first year depreciation deduction under Code section 168(k)**, which allows a 100-percent additional first year depreciation deduction for qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023 (with some exceptions). The proposed rules explain the requirements for depreciable property to qualify for the additional first year depreciation deduction. They also instruct on how to determine the additional first year depreciation deduction and the amount of depreciation otherwise allowable for this property.

Technical Corrections

Ways & Means Committee Chairman Brady (R-TX) continues to say that technical corrections legislation will move separately from a Tax Reform 2.0 package and mostly likely after the mid-term elections in order to give Treasury and the IRS more time to work on TCJA guidance. One issue will be finding a "vehicle" for it to be attached to that will be considered in a lame duck session. The Senate tax title to the FAA reauthorization bill is identical to what was passed in the House and no longer an option.

SFC Chairman Hatch (R-OR) and all Republican committee members sent a letter to Treasury and the IRS outlining three policy areas which they believe are in need of technical corrections under the TCJA. The letter asks Treasury and the IRS to issue guidance that is consistent with the Congressional intent of the new tax law regarding qualified improvement property expensing, the net operating loss (NOL) deduction, and the sexual misconduct settlement deduction. The letter states that the committee continues to review the law for other possible areas that may need regulatory or legislative refinement, and that the intent is to introduce technical corrections legislation to address these items.

TCJA Guidance (continued)

Section 965 Transition Tax: Treasury **released proposed regulations related to the section 965 transition tax**, which imposes a one-time deemed repatriation tax on the accumulated earnings of US multinationals' foreign subsidiaries providing guidance for taxpayers on including the tax on their 2017 returns. Section 965 would tax overseas cash holdings at 15.5% and non-cash earnings at 8%, by deeming those funds repatriated to the US in 2017, with no future tax cost. Determining how to distinguish between cash and non-cash earnings has proven to be a difficult task for taxpayers and the IRS. The law included measurement dates of November 2, 2017, when the tax reform bill was first introduced in the House, and December 31, 2017. The proposed regulations affect US shareholders, as defined in Code section 951(b), with direct or indirect ownership in certain foreign corporations, as under Code section 965(e). The lower effective tax rates applicable to Code section 965 income inclusions are reached using a participation deduction set forth in Code section 965(c). A reduced foreign tax credit also applies with respect to the inclusion under Code section 965(g).

Taxpayers may generally elect to **pay the transition tax in installments** over an 8-year period under Code section 965(h). The guidance contains detailed information on the calculation and reporting of a US shareholder's Code section 965(a) inclusion amount, as well as information for making the elections. The new rules generally track earlier guidance and the statutory language rather than "interpreting" the law in a way that might have a significant impact on companies either to their benefit or detriment. They provide more detail on issues addressed in prior Code section 965 notices, but they **also addressed some issues for the first time**, including foreign tax credits and basis adjustments. They **do not address specific individual cases** despite requests from taxpayers, stating that to do so would have been difficult to enforce and Congressional intent was clear.

Global Intangible Low-Taxed Income (GILTI): Treasury has submitted the first in what is expected to be a series of proposed regulations on global tax anti-avoidance rules to the Office of Management and Budget (OMB) for review. There is no announced date for completion of the review, but it is **expected that these regulations will be released in the coming weeks.** Treasury earlier this year set the release date for October.

The **GILTI rules are considered to be a key element of the TCJA international framework** by targeting income from intangible assets, such as intellectual property, held by US companies in low-tax foreign jurisdictions. The initial package of regulations are expected to address computational issues, with subsequent **rules expected to address other important issues such as** how foreign tax credit (FTC) limitations will apply to GILTI income, expense allocation, consolidated filers, and the accumulated earnings tax under section 531.

Method of Accounting changes: Revenue Procedure 2018-40 provides the procedures by which a small business taxpayer may obtain **automatic consent to change its methods of accounting** to reflect certain statutory changes made by the TCJA and requests comments with suggestions for future guidance under Code sections 263A, 447, 448, 460, and 471 to implement these changes. The new law generally expanded the number of small business taxpayers eligible to use the cash method of accounting to include taxpayers with average annual gross earnings of $25 million or less and exempted certain small business taxpayers from the requirements to capitalize costs under Code section 263A, to account for certain long-term contracts using the percentage completion method under Code section 460, and to account for inventories under Code section 471.

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Susan Rogers has 30 years of experience in the tax policy field in Washington including several years as Majority Tax Counsel to the House Ways & Means Committee and extensive experience managing global tax issues for a Fortune 100 multinational. Ms. Rogers' practice focuses on providing information and strategic advice to clients on US and international tax policy issues and advice on how to manage tax policy risks.