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Tax Extenders Included in Bipartisan Budget Act

The Bipartisan Budget Act (Act) was signed into law after a brief government shutdown in February. The legislation contains tax provisions in addition to a continuing resolution to fund the government and federal agencies through March 23. The House approved this new law in the early morning hours of February 9, by a 240-to-186 vote. The Senate approved the bipartisan measure a few hours earlier, by a 71-to-28 vote.

The Act contains a significant number of tax provisions, including disaster tax relief and the extension of more than 30 expired tax breaks. The majority of the tax relief included in the legislation applies to the 2017 tax year only. The full impact of these retroactive changes on the current filing season remains to be fully assessed. The IRS issued a statement on February 9, saying that it was beginning to determine next steps. “The IRS will provide additional information as quickly as possible for affected taxpayers and the tax community,” the Service indicated.

Extenders

Highlights of some of the tax extender provisions with more widespread impact than others are as follows (and are extended through 2017 only unless 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
- 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
- Credit for nonbusiness energy property
- Credit for nonresidential energy property (extended through 2021 and modified)
- Credit for new qualified fuel cell motor vehicles

- Credit for alternative fuel vehicle refueling property
- Credit for two-wheeled plug-in electric vehicles
- Second generation biofuel producer credit
- Biodiesel and renewable diesel incentives
- 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
- Carbon dioxide sequestration credit (enhanced, modified and generally extended through 2023)

Disaster relief

The Act also established disaster tax relief for individuals and businesses impacted by California wildfires. Such relief includes, but is not limited to, allowing certain access to retirement funds, temporarily suspending the limit on charitable contribution deductions, allowing deductions for personal casualty disaster losses and a tax credit for employee retention. The Act also includes changes to the Opportunity Zones rules for Puerto Rico, originally included in the "Tax Cuts and Jobs Act" (TCJA). Additionally, tax relief is extended for areas affected by hurricanes Harvey, Irma, and Maria.

Additional tax provisions

A number of new tax provisions were included in the legislation, as well as modifications to existing tax provisions. These include modifications of the rules relating to whistleblower awards, user fees on installment agreements, and hardship distributions and withdrawals from deferred accounts. The TCJA also mandates the creation of a new version of Form 1040, similar to a Form 1040EZ, for seniors, for tax years beginning after February 9, 2018 (the 2019 tax year for calendar year taxpayers). An additional provision of note is the requirement that for the excise tax on investment income of private colleges and universities to apply, the 500 students must be "tuition-paying." This requirement was included in the original version of the TCJA, but was removed at the last minute to comply with budget reconciliation rules.

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Treasury Moves To Repeal 298 Unnecessary, Obsolete Regulations

The Treasury Department has proposed repealing 298 regulations. According to the Treasury, the targeted rules are unnecessary, duplicative, or obsolete. In addition, the Treasury proposed to amend another 79 regulations to reflect the repeal.

“We continue our work to ensure that our tax regulatory system promotes economic growth,” Treasury Secretary Steven Mnuchin said in a statement. “These 298 regulations serve no useful purpose to taxpayers and we have proposed eliminating them. I look forward to continuing to build on our efforts to make the regulatory system more efficient and effective.”

Background

The Treasury began reviewing IRS regulations in response to two Executive Orders (EO) issued in 2017. The first EO directed each agency to establish a Regulatory Reform Task Force. In addition, each Regulatory Reform Task Force was directed to review existing regulations to determine which, among other things, were outdated, unnecessary, or ineffective. The second EO directed the Treasury to review all significant tax regulations issued on or after January 1, 2016. Accordingly, on June 22, 2017, the Treasury issued an interim report identifying eight regulations to be revised or withdrawn. On October 2, 2017, the Treasury issued a second report noting that the IRS Office of Chief Counsel had identified more than 200 regulations for potential repeal.

Executive review

Treasury did not describe to what extent, if any, the Office of Information and Regulatory Affairs (OIRA) is reviewing tax regulations. Under Executive Order 12866 (Regulatory Planning and Review), a regulatory action is "significant" if it is likely to result in a rule that: (1) has an annual effect on the economy of $100 million or more or adversely affects the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or state, local, or tribal governments or communities; (2) creates a serious inconsistency or otherwise interferes with another agency’s actions taken or planned; (3) materially alters the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raises novel legal or policy issues.

Unnecessary, obsolete regulations

The regulations to be repealed fall into three categories: (1) Regulations interpreting Code provisions that have been repealed; (2) Regulations interpreting significantly revised Code provisions that do not reflect the revisions; and (3) Regulations that are no longer applicable.

Moreover, removal is unrelated to the substance of rules they contain. Therefore, there is no negative inference regarding the stated rules. The IRS proposes to remove these regulations from the Code of Federal Regulations (CFR) solely because they have no current or future applicability. In addition, the IRS’s repeal of these regulations is not intended to alter any nonregulatory guidance that cites to or relies upon them. Further, the Treasury proposes to amend 79 existing regulations to remove cross-references to the 298 repealed regulations.

According to the Treasury, these amendments will streamline and reduce the volume of regulations taxpayers need to review and increase clarity of the tax law. These regulations will be repealed as of the date the Treasury decision adopting these proposals is published in the Federal Register. Treasury requested comments on the proposal. Written or electronic comments and requests for a public hearing must be received by May 14, 2018.

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Administration's FY 2019 Budget Prioritizes IRS Enforcement, Proposes Few Tax-Law Changes

The Trump administration had released its much-anticipated fiscal year (FY) 2019 budget request, "Efficient, Effective, Accountable An American Budget." The administration's proposal calls for IRS funding that focuses additional resources on enforcement and cybersecurity. Coming off passage of the Tax Cuts and Jobs Act, this year's budget recommendations contain only a handful of additional tax proposals when compared to some prior-year budget requests.

Presidential budget requests are not binding; rather, the requests offer a legislative proposal for congressional lawmakers to consider. A Treasury Department "Green Book" that traditionally outlines an administration's revenue proposals for the coming year is not expected this year in light of the Tax Cuts and Jobs Act's recent passage. Some practitioners have expressed concern that not enough resources in the proposed budget would be allocated toward providing guidance to fully implement the new law.

IRS

The administration's budget proposal breaks its IRS funding request into four parts. The administration proposes allocating $11.1 billion in base funding, $2.3 billion for key tax filing and compliance initiatives, and $110 million for IT modernization efforts. Additionally, funding is requested to expand and strengthen tax enforcement.

Tax provisions

In addition to IRS funding, the administration's 2019 budget requests certain tax changes. These changes, among others, would include provisions to provide more oversight of paid tax preparers, require valid Social Security Numbers when claiming the earned income and child tax credits, allow the IRS more flexibility in correcting errors on tax returns that seek refunds, allow Medicare recipients with high deductible plans to make tax-deductible contributions to health savings accounts, and, as part of the administration's infrastructure plan, expand by $6 billion the use of tax-exempt private activity bonds.

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IRS Releases Second Quarter Guidance Update; Focus On New Law

The Treasury and IRS have released their second quarter update to the 2017-2018 Priority Guidance Plan (Plan). The updated Plan now reflects 29 additional projects, including 18 projects that have become near-term priorities as a result of the Tax Cut and Jobs Act of 2017 (TCJA). As in the past but made more urgent by the TCJA, the IRS intends to update its cumulative Plan to consider comments received from taxpayers and tax practitioners relating to additional projects and to respond to developments arising during the plan year.

Response to new law

Part 1 of the updated Plan contains plans for guidance on 18 targeted areas, including the following:

- Internal Revenue Code (IRC) Section 45S business credits with respect to wages paid to qualifying employees during family and medical leave
- Application of the effective date provisions under IRC Section 162(m) to the elimination of the exceptions for commissions and performance-based compensation from the definition of compensation subject to the deduction limit
- Fines and penalties under IRC Section 162(f) and new IRC Section 6050X
- Computational, definitional, and other matters under new IRC Section 163(j) on the deduction of business interest
- Bonus depreciation under new IRC Section 168(k)
- Computational, definitional, and anti-avoidance matters under the new IRC Section 199A passthrough deduction
- Adopting new small business accounting method changes under IRC Section 263A, 448, 460 and 471
- Implementing changes to IRC Section 529 college savings plans
- Implementing changes to IRC Section 1361 regarding electing small business trusts
- Computation of estate and gift taxes to reflect changes in the basic exclusion amount
- Withholding under IRC Sections 3402 and 3401 and optional flat rate withholding

IRS resources

Although IRS officials have said that its updated list is not exclusive, they have emphasized that the items on the list will be their first order of business, which they hope to get through by July. Treasury Secretary Steven Mnuchin predicted in mid-January that the IRS will hire more employees to implement the TGJA: "Our number one issue is implementing the new tax law," Mnuchin said.

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IRS Issues Guidance On Accounting Period Changes By Foreign Corporations To Prevent Avoidance of Transition Tax

The IRS has issued guidance for certain specified foreign corporations owned by U.S. shareholders subject to the Internal Revenue Code (IRC) Section 965 transition tax that are requesting a change in accounting period. The IRS will not approve a request to change the annual 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. This guidance applies to any request to change an annual accounting period that ends on December 31, 2017, regardless of when such request was filed.

Before the newly issued guidance, a specified foreign corporation with a tax year ending on December 31, 2017, could have avoided the purposes of IRC Section 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 a U.S. shareholder's inclusion with respect to the DFIC by as much as 11 months. The election could also reduce the amount of the tax liability of a U.S. shareholder of the DFIC through the reduction of the post-1986 earnings and profits of the DFIC. Rev. Proc. 2002-39 and Rev. Proc. 2006-45 are modified.

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IRS Posts Best Practices For Individual Mandate

The IRS has posted best practices for return preparers addressing the Affordable Care Act's (ACA) individual shared responsibility requirement, also known as the individual mandate. The Service reminded preparers that the Tax Cuts and Jobs Act did not eliminate the individual shared responsibility requirement for 2017. The IRS has cautioned that it will not consider a 2017 return complete and accurate if the taxpayer does not report coverage, claim an exemption, or report a shared responsibility payment. In past years, the IRS processed these so-called "silent returns."

Individual mandate

Individuals without minimum essential health coverage must make a shared responsibility payment, unless exempt. Individuals with employer-provided health insurance, Medicaid and Medicare, and certain other health insurance coverage, generally are treated as having minimum essential coverage. Some exemptions may be obtained from the ACA Marketplace. Other exemptions may be claimed on a taxpayer's return. These exemptions include individuals who are members of federally recognized Native American Nations, individuals who are incarcerated, individuals with a short gap in coverage, certain hardships, and more. Individuals make a shared responsibility payment when they file their returns. The payment is a flat dollar amount or a percentage of income, whichever is greater.

Best practices

A client can show he or she had minimum essential coverage by a number of methods, the IRS explained. The ACA requires certain large employers to inform employees about their health coverage. Clients with coverage through the ACA Marketplace also receive notification. Individuals with government-provided coverage, such as Medicaid and Medicare, should have supporting documents. A client might not have proof of coverage, the IRS noted. In this case, the preparer should discuss the nature of the coverage including the months the client was covered to get a reasonable assurance so the preparer can accurately complete the tax return, the IRS explained.

Going forward

The Tax Cuts and Jobs Act effectively repealed the individual shared responsibility requirement by making any payment due $0. However, this change takes effect for months beginning after December 31, 2018. The individual shared responsibility requirement remains unchanged for 2017 and 2018.

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Interest on Home Equity Loans Often Still Deductible under New Law

The IRS had advised taxpayers that in many cases they can continue to deduct interest paid on home equity loans.

Responding to many questions received from taxpayers and tax professionals, the IRS said that despite newly enacted restrictions on home mortgages, taxpayers can often still deduct interest on a home equity loan, home equity line of credit (HELOC) or second mortgage, regardless of how the loan is labelled. The Tax Cuts and Jobs Act of 2017, enacted December 22, suspends the deduction for interest paid on home equity loans and lines of credit from 2018 until 2026, unless they are used to buy, build, or substantially improve the taxpayer's home that secures the loan.

Under the new law, for example, interest on a home equity loan used to build an addition to an existing home is typically deductible, while interest on the same loan used to pay personal living expenses, such as credit card debts, is not. As under prior law, the loan must be secured by the taxpayer's main home or second home (known as a qualified residence), not exceeding the cost of the home and meeting other requirements.

New dollar limit on total qualified residence loan balance

For anyone considering taking out a mortgage, the new law imposes a lower dollar limit on mortgages qualifying for the home mortgage interest deduction. Beginning in 2018, taxpayers may only deduct interest on $750,000 of qualified residence loans. The limit is $375,000 for a married taxpayer filing a separate return. These are down from the prior limits of $1 million, or $500,000 for a married taxpayer filing a separate return. The limits apply to the combined amount of loans used to buy, build or substantially improve the taxpayer's main home and second home.

The following examples illustrate these points.

Example 1: In January 2018, a taxpayer takes out a $500,000 mortgage to purchase a main home with a fair market value of $800,000. In February 2018, the taxpayer takes out a $250,000 home equity loan to put an addition on the main home. Both loans are secured by the main home and the total does not exceed the cost of the home. Because the total amount of both loans does not exceed $750,000, all of the interest paid on the loans is deductible. However, if the taxpayer used the home equity loan proceeds for personal expenses, such as paying off student loans and credit cards, then the interest on the home equity loan would not be deductible.

Example 2: In January 2018, a taxpayer takes out a $500,000 mortgage to purchase a main home The loan is secured by the main home. In February 2018, the taxpayer takes out a $250,000 loan to purchase a vacation home. The loan is secured by the vacation home. Because the total amount of both mortgages does not exceed $750,000, all of the interest paid on both mortgages is deductible. However, if the taxpayer took out a $250,000 home equity loan on the main home to purchase the vacation home, then the interest on the home equity loan would not be deductible.

Example 3: In January 2018, a taxpayer takes out a $500,000 mortgage to purchase a main home The loan is secured by the main home. In February 2018, the taxpayer takes out a $500,000 loan to purchase a vacation home. The loan is secured by the vacation home. Because the total amount of both mortgages exceeds $750,000, not all of the interest paid on the mortgages is deductible. A percentage of the total interest paid is deductible.

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California Employers Continue to Pay Higher Federal Unemployment Tax

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Because California has relied on federal loans to pay regular Unemployment Insurance (UI) benefits and has not repaid the loans, California employers saw another increase in their federal unemployment taxes in January 2018 for wages paid to their workers in 2017.

California employers were subject to a 2.1% credit reduction on their 2017 federal unemployment tax return (a maximum $147 increase per employee) because of the state's failure to repay its outstanding federal loans for seven consecutive years. Currently, the only other jurisdiction also subject to the credit reduction is the Virgin Islands.

Credit reduction

The standard Federal Unemployment Tax Act (FUTA) rate is 6.0%, but generally employers with a good claim rate history receive a 5.4% credit against the 6.0% rate. However, this credit is reduced in states that have an outstanding loan balance with the federal government. Under Title XII of the Social Security Act, states can borrow funds from the federal government to pay unemployment benefits. The same provision provides that the federal government can recover the funds by reducing the FUTA credit it gives to employers. When a state has an outstanding loan balance on January 1 for two consecutive years, and the loan is not repaid by November 10 of the second year, the state FUTA credit is reduced until the loan is repaid. California borrowed funds from the federal government in 2009, but because California has not repaid its loan, California employers pay more federal FUTA taxes.

The reduction is 0.3% for the first year and an additional 0.3% for each succeeding year until the loan is repaid. From the third year onward, there may be additional reductions in the credit, although California has received waivers from these additional reductions. California is now in its seventh year of credit reduction for a total reduction of 2.1%.

Loan to be paid off

It is anticipated that California will pay off its loan in 2018. Should that occur, employers will see their FUTA rate reduction go from 2.1% to 0.06% next year. If that does not occur, California's rate reduction will increase to 2.4%, or an additional $21 per employee.

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