

2017 Tax Year-In-Review

January 2, 2018

Highlights

- ✓ Sweeping Overhaul of Tax Code
- ✓ Executive Orders Impact Regs
- ✓ Centralized Partnership Audit Regime Regs
- ✓ Gig Economy/Other Trending Issues
- ✓ Declining Audit Rates
- ✓ Higher Social Security Wage Base
- ✓ Disaster Loss Safe Harbors

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SPECIAL REPORT

Tax Code Overhaul, Regs and Court Decisions Make 2017 Stand-Out Year

A review of the most significant developments of 2017 starts with the Tax Cuts and Jobs Act of 2017, the first major “tax reform” law enacted since 1986. In spite of its overall drive toward a “more simple tax code,” the new law has already created confusion over many of its provisions for individuals, and even more so for businesses. The provisions within the new law are generally not effective until January 1, 2018, although some reach back into late 2017. As taxpayers deal with these new rules, however, they must also address scores of other changes to the tax law that were made throughout 2017 by Congress, the IRS and the courts that directly impact the 2017 tax year. With the 2018 tax filing season coming up, knowing the impact of 2017 changes on about-to-be-filed 2017 tax-year returns is critical.

COMMENT. *As 2018 begins, taxpayers and tax professionals are trying to sort through the countless changes that have just been made by the Tax Cuts and Jobs Act. Unlike some previous years, however, the IRS enters 2018 without having to make many significant changes to 2017 tax forms in time for the upcoming 2018 filing season. Few changes in the Tax Cuts and Jobs Act are retroactive. However, the IRS must now devote resources to developing guidance under the Tax Cuts and Jobs Act.*

MAJOR CHANGES

A sweeping rewrite of the nation’s tax laws passed Congress in late 2017. The *Tax Cuts and Jobs Act* permanently lowers the corporate tax rate and temporarily lowers the individual tax rates. The Act also temporarily enhances the child tax credit, the medical expense deduction, bonus depreciation, small business expensing, and more. Lawmakers, however, did not repeal the federal estate tax or the alternative minimum tax (AMT) for individuals, although they did add temporary sweeteners to these provisions. *For more details and analysis, see the special Briefing, Tax Cuts and Jobs Act.*

Tax Reform – Initial Strategies

Passage of the *Tax Cuts and Jobs Act* has triggered an avalanche of questions. “Simplification” of the tax code may be the end-result for many taxpayers who will take a higher standard deduction instead of computing a variety of itemized deductions. But, even for many of those taxpayers, loss of deductions




for homeownership and state/local taxes complicates matters significantly.

Taking personal inventory. Immediate concerns after passage of the *Tax Cuts and Jobs Act* are focused on what tax breaks are eliminated after 2017, as well as what elections may be made on 2017 tax returns to lower 2017 taxable income. Taking inventory of these deductions and credits and adopting new strategies to maximize benefits under the revised code as early as possible in 2018 are important initial steps.

“With the 2018 tax filing season coming up, knowing the impact of 2017 changes on about-to-be-filed 2017 tax-year returns is critical.”

Businesses. The *Tax Cuts and Jobs Act* calls for immediate, 100 percent expensing for the purchase of business equipment. The rules are complex and taxpayers need to consider the downstream impact on subsequent years during which the asset is still in use but not depreciable. Businesses should evaluate the impact of new lower tax rates and expensing provisions on operations going forward. The loss of certain business deductions and credits and new limitations on interest deductions also need careful consideration.

Choice-of-entity considerations. Pass-through entities and their owners have major decisions to make under the new tax law. How will they fit into the complicated qualifications for the 20 percent tax deduction and its many exceptions? For some pass-through owners, reevaluating their active-versus-passive activity within the business should be at the top of their to-do list. For other business owners, conversion into “C” corporations should be considered. The *Tax Cuts and Jobs Act* lowered the corporate tax rate to 21 percent after 2017.

 **IMPACT.** *One of the first guidance projects is likely to be new withholding tables reflecting the Tax Cuts and Jobs Act. In December, the IRS reported that initial withholding guidance (Notice 1036) will be posted in January 2018*


Regulatory Resets and Reform

Since taking office, President Trump has issued several Executive Orders (EOs) on regulations. *EO 13789* directed

the Treasury Department to review all significant tax regulations issued since January 1, 2016. In July, the Treasury Department identified eight recent tax regulations for reevaluation. The Treasury Department later withdrew two regulations: Proposed Regulations under Code Sec. 2704 on Restrictions on Liquidation of an Interest for Estate, Gift and Generation-Skipping Transfer Taxes (*REG-163113-02*) and Proposed Regulations under Code Sec. 103 on Definition of Political Subdivision (*REG-129067-15*).

Although all tax regulations are subject to re-examination and revision, the Treasury Department has specifically targeted regulations in six areas for probable action early in 2018:


- Code Sec. 385 on the treatment of certain interests in corporations as stock or Indebtedness, *to be revoked and replaced.*
- Code Sec. 7602 on summons interviews, *to be partially withdrawn;*
- Code Sec. 752 on liabilities recognized as recourse partnership liabilities, *to be partially withdrawn or studied;*
- Code Sec. 337(d) on property transfers to RICs and REITs, *to be revised and narrowed;*
- Code Sec. 367 on property transfers to foreign corporations, *to be substantially revised;* and
- Code Sec. 987 on currency gain or loss for Qualified Business Units, *to be postponed and simplified.*

 **COMMENT.** *Additional actions are likely to come in early 2018, both to deliver on the Treasury's initial recommendations and to start issuing guidance under the Tax Cuts and Jobs Act.*

Audit Coverage

The IRS's *2016 Data Book*, released in 2017, provides the most up-to-date snapshot of the Service's activities (IR-2017-69). The IRS audited 0.7 percent of all individual income tax returns in calendar year (CY) 2015, an all-time low. Approximately two-thirds of those individual audits were correspondence audits and one-third were field audits.

The Treasury Inspector General for Tax Administration (TIGTA) reported in September that the IRS examined one of every 143 individual income tax returns in fiscal year (FY) 2016. This reflected a 16 percent decline compared to FY 2015, according to TIGTA. The IRS examined one in 17 returns in FY 2016 with more than \$1 million in income, which, according to TIGTA, represented a decline of 29 percent compared to FY 2015.

 **COMMENT.** *Just days before leaving office on November 12, former IRS Commissioner John*

Koskinen repeated his warning to Congress that the IRS has become dangerously underfunded. “If IRS funding continues to be cut, tax administration (including the IT ability to process refunds and to audit properly) will fail...it is not a question of whether, but simply a question of when,” Koskinen warned.

Health Care

After dominating the first half of the 2017 news cycle, Congressional efforts to repeal and replace the *Affordable Care Act* eventually failed when the Senate Republicans’ “skinny repeal” legislation, the Health Care Freedom Bill, failed during a dramatic, past-midnight vote on July 28.

Individual mandate. The *Tax Cuts and Jobs Act* effectively repeals the individual mandate by making the payment amount \$0.

IMPACT. This change is predicted to have a significant impact on the cost of health insurance for many of those who opt to remain in the health care system.

ACA taxes. The 3.8 percent net investment income tax (NII tax), and its “companion” 0.9 percent Additional Medicare Tax on compensation, which were enacted as part of the *Affordable Care Act*, have not been repealed. Whether momentum for their repeal in 2018, retroactive to January 1, 2018, takes hold is speculative at this time.

COMMENT. At the time this Briefing was prepared, legislation had been introduced to extend the current suspensions of the ACA’s excise tax on high-dollar health plans, medical device excise tax and health insurance provider fee.

Employer shared-responsibility coverage/payment.

The employer side of complying with the ACA continues to be enforced rigorously by the IRS. In late 2017, the IRS updated FAQs on its website about the ACA’s Employer Shared Responsibility Payment (ESRP) and developed Letter 226J, which is being sent to employers who may be non-compliant.

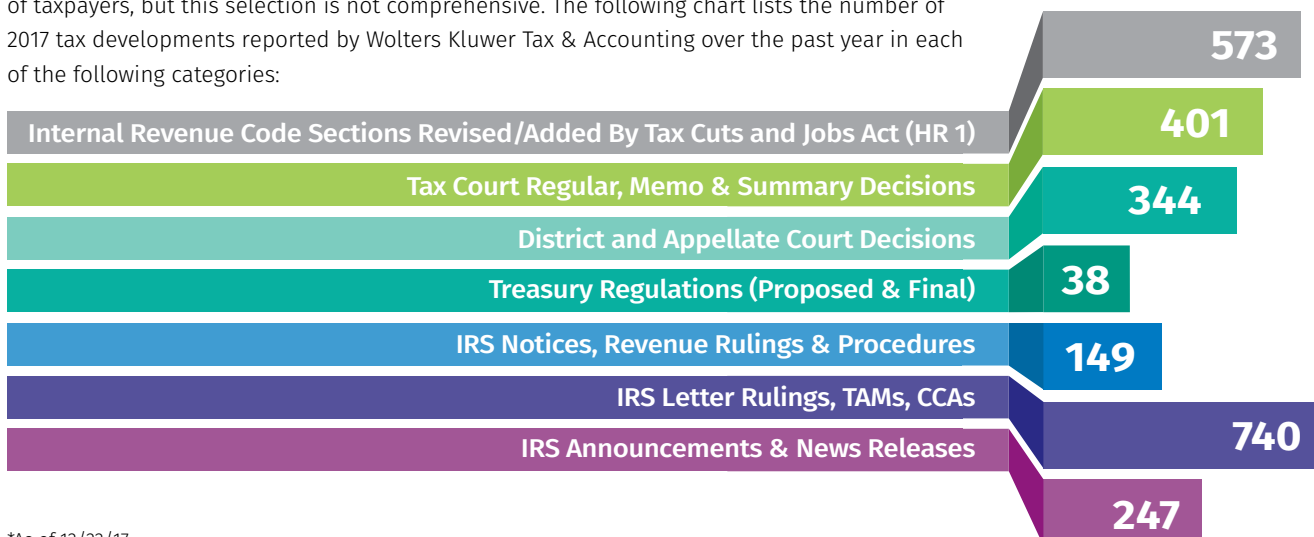
Enrollment/coverage. In February 2017, the U.S. Department of Health and Human Services issued proposed changes to regulations governing enrollment and coverage in plans offered through ACA Marketplaces. The 2018 enrollment period was shortened to November 1 – December 15, 2017.

Premium assistance credit. The IRS released the updated applicable percentages for the Code Sec. 36B premium assistance tax credit and the individual shared responsibility requirement (*Rev. Proc. 2017-36*).

QSEHRAs. The IRS issued guidance on qualified small employer health reimbursement arrangements (QSEHRAs) to explain who may participate, dollar limits, and more (*Notice 2017-67*). In response to a recent Executive Order, the IRS predicted more guidance will be issued on QSEHRAs.

2017 Tax Developments—By The Numbers*

The number of tax developments in 2017 was much greater than can be highlighted in this Tax Briefing. Developments here were selected based upon their impact on a broad cross-section of taxpayers, but this selection is not comprehensive. The following chart lists the number of 2017 tax developments reported by Wolters Kluwer Tax & Accounting over the past year in each of the following categories:




*As of 12/22/17

TRENDING ISSUES

In addition to developments surrounding the *Tax Cuts and Jobs Act*, the shift in scope and focus of tax regulations, the IRS efforts to turn back declining audit rates, and the potential health care changes coming in 2018, another group of 2017 developments is also noteworthy. Notable either for breaking new ground or for their potential impact on a large number of taxpayers, the following developments also deserve to be highlighted.


The Gig or Sharing Economy

The IRS is taking notice of the gig, or sharing, economy. The Service opened a Sharing Economy Tax Center on its website, and is educating agents on relevant examination techniques. Activities in the sharing economy can vary and can range from selling goods online, advertising or other revenue from a website or blog, creating a crowdfunding site, short-term renting out a residence, or driving others for hire. More of these activities have come to the attention of the IRS as new Form 1099-K reporting requirements emerge for online and credit card transactions, as well as the use of Form 1099-MISC by large facilitators for service or goods providers.

 **IMPACT.** *The new information-reporting requirements help create a clear audit trail for the IRS if the tax return does not match what was reported by the facilitator.*

Worker Classification


Closely aligned with the gig economy and the issues it generates, the IRS issued an important fact sheet reminding employers of the importance of correctly classifying workers for purposes of federal employment taxes (FS-2017-9). Whether a worker is an employee or an independent contractor depends on a number of factors that fall into three categories: behavioral control, financial control and the type of relationship between the worker and the service recipient.

 **IMPACT.** *An employer that incorrectly classifies employees as independent contractors may be liable for employment taxes. However, the IRS emphasizes remedial measures that may be taken both before and after classification takes place.*

Cybersecurity

2017 saw the IRS reporting that it finally is turning the tide against fraudulent claims for refunds. The Service


is working closely with software providers and using IT to more closely monitor patterns in filed tax returns. Delaying 2017 refunds for taxpayers claiming the earned income tax credit and the additional child tax credit also saw results. But while the situation surrounding refund-fraud is improving, it is far from eliminated, the IRS has emphasized.

 **COMMENT.** *The IRS's message to return preparers throughout 2017 focused on need for practitioners to protect themselves as well as their clients by taking steps to keep their confidential data as secure as possible.*

Virtual Currency

Bitcoin has become the virtual currency of-choice worldwide in just a short period of time. Bipartisan legislation was introduced in September in Congress to allow consumers to make small purchases with virtual currency (also known as cryptocurrency) of up to \$600 without needing to satisfy current reporting requirements (the *Cryptocurrency Tax Act of 2017*). Meanwhile, many stakeholders said that IRS policy needs updating.


 **COMMENT.** *In Notice 2014-21, the IRS explained that transactions using virtual currency must be reported in U.S. dollars for U.S. tax purposes. Taxpayers must determine the fair market value of virtual currency in U.S. dollars as of the date of payment or receipt. Since then, the Treasury Inspector General for Tax Administration (TIGTA) has observed that there has been little coordination between the responsible agency functions to identify and address potential taxpayer noncompliance. That, however, may be changing. A federal district court in November (Coinbase, Inc., DC-Calif., November 28, 2017) directed a virtual currency platform to comply with an IRS summons seeking information about more than 14,000 account holders.*

 **IMPACT.** *The Tax Cuts and Jobs Act now will prevent deferring gain on the exchange of one virtual currency for another.*


Partnership Audit Rules

The new centralized partnership audit regime under the *Bipartisan Budget Act of 2015 (BBA)* replaces the current TEFRA (*Tax Equity and Fiscal Responsibility Act of 1982*)

procedures beginning for 2018 tax year audits, with an earlier “opt-in” for electing partnerships.

 **Comment.** *These rules dramatically change the way that audit adjustments are imposed on the partnership and its partners. With an estimated one million-plus partners under the U.S. tax system, the importance of the centralized partnership audit regime cannot be underplayed. Partnerships and their partners, if they have not done so, should review partnership agreements to address these new issues.*

Overall proposed regulations on the new centralized partnership audit regime were issued in early January 2017 only to be pulled back for reconsideration by the Trump Administration. The regulations were re-issued, with minor changes, in June 2017 and then again as final regulations in late December.

 **COMMENT.** *Practitioners and the IRS agree that they are incomplete, with many rules to be filled-in as Congress had intended.*

 **COMMENT.** *In November, the IRS issued proposed regulations on how certain international rules operate within the framework of the new centralized partnership audit regime (NPRM REG-119337-17). In December, the IRS issued proposed regulations on the operation of the “push-out” rules for partner/partnership liability in tiered structures (NPRM REG-120232-17). Under the IRS and Treasury Department’s “2017-2018 Priority Guidance Plan,” more regulations are expected.*

LB&I Audit Campaigns

One solution to declining audit numbers was inaugurated and then expanded in 2017 by the IRS Large Business and International (LB&I) Division: Issue-Based Compliance Campaigns. These campaigns are designed to help LB&I move in the direction of issue-based examinations. They spotlight various issues of tax compliance.

The LB&I audit campaign list, as announced in early 2017, identified 13 campaigns, including the Offshore Voluntary Disclosure Program; related-party transactions; basket transactions; and S corporation losses claimed in excess of basis.

In November, LB&I selected 11 more compliance campaigns, identified through LB&I data analysis and suggestions from IRS compliance employees.

OTHER MAJOR 2017 DEVELOPMENTS

During 2017, there were over 1,500 new developments reported in *Federal Tax Day* (Wolters Kluwer). Some confirmed or elaborated on the application of existing law. Others were unique, either in their analysis or in their application. In addition to those already covered, the following 2017 developments, are notable.

Retirement Planning

Pension plans. The U.S. Supreme Court held that a defined benefit (DB) plan maintained by a principal-purpose organization controlled by a church for the church’s employees, qualifies as a church plan (*Advocate Health Care Network v. Stapleton, S.Ct., June 5, 2017*).

Annuities. The IRS released model amendments that a sponsor of a qualified defined benefit plan may use to amend its retirement plan document to offer bifurcated benefit distribution options to participants (*Notice 2017-44*).

Hardship withdrawals. A taxpayer persuaded the Tax Court that his struggle with depression qualified him for a hardship waiver of the 60-day retirement account rollover rule (*Trimmer, 148 TC No. 14*).

myRAs. The IRS announced that the myRA savings program, launched by the Treasury Department in 2015, will be discontinued based on low demand (*TDNR SM-0135*).

2018 COLAs. Many inflation-sensitive retirement plan contribution benefit limits will rise in 2018, after remaining flat for several years, the IRS announced (*Notice 2017-64*). Notably, the employee elective deferral limit under 401(k) plans increased \$500 to \$18,500, after remaining at the \$18,000 level for the prior three years.

DISC-Roth IRA arrangement. Reversing the Tax Court, the Sixth Circuit Court of Appeals held that a DISC-Roth IRA arrangement that allowed a Roth IRA to sidestep annual Roth contribution limits must be respected (*Summa Holding, Inc., CA-6, February 16, 2017*).

Deductions and Exclusions

Charitable deductions and substantiation. The IRS continued to be aggressive in protecting use of the charitable deduction that requires following the letter of the law on form and substantiation. Before the courts, the IRS won some (for example, *Izen, 148 TC No. 5*) and (*RERI Holdings I, LLC, 149 TC No. 1*); and lost others (for example, *BC Ranch II, L.P., CA-5, August 11, 2017*).

Clergy housing exclusion. A federal district court struck down the clergy housing exclusion, finding that the tax preference violates the Establishment Clause of the First Amendment (*Gaylor, DC-Wisc., October 6, 2017*).

Business Guidance

Section 179/Bonus Depreciation. The IRS issued guidance to clarify changes made to the expensing allowance under Code Sec. 179 as well as the Code Sec. 168(k) bonus depreciation deduction by the *Protecting Americans From Tax Hikes Act of 2015* (PATH Act) (*Rev. Proc. 2017-33*).

“Repair reg” requirements. The IRS announced an extension of the waiver of the eligibility rule for an additional year for taxpayers making certain automatic accounting method changes under the final tangible property regulations (*Notice 2017-6*).

Meals away from home. In a court victory by a professional hockey team owner, providing away-from-home pre-game team meals was entitled to a full deduction because the team’s rigorous travel schedule made “away” games almost the equivalent of “home” games (*Jacobs, 148 TC No. 24*).

Per diem rates. The IRS announced the 2017-2018 special per diem travel rates to be used in substantiating as ordinary and necessary an employer’s reimbursement of amounts incurred while traveling away from home. The IRS-approved per diem rate for high-cost areas is \$284 (up from \$282). The IRS-approved per diem rate for all other areas is \$191 (up from \$189) (*Notice 2017-54*).

Standard mileage rate. The IRS announced that the standard mileage rate for 2018 is 54.5 cents per mile, up from 53.5 cents per mile for 2017 (*IR-2017-204*).

Social Security wage base. The Social Security wage base for FICA withholding in 2018 will rise to \$128,400 (up from \$127,200 in 2017) (www.ssa.org).

COMMENT. The Social Security Administration originally announced the wage base would be \$128,700 for 2018. The agency later revised its calculations, resulting in a wage base of \$128,400 for 2018.

Reverse like-kind exchanges. The IRS announced its nonacquiescence (AOD 2017-6) in a Tax Court decision on reverse like-kind exchanges.

Return filing. The IRS announced relief from penalties for entities required to file partnership returns by the new due date for tax years beginning in 2016 (*Notice 2017-71*).

Corporate Reorganizations

Corporate spin-offs. Corporate spinoffs under Code Sec. 355 were given more advance “comfort” by the IRS in guidance that eased up on the issuance of advance private letter rulings on several fronts by:

- Lifting its no-rule policy on north-south spin-offs (*Rev. Rul. 2017-09*); and
- Removing stock-for-debt leveraged spinoffs from the no-rule list (*Rev. Proc. 2017-38*).

Later in the year, the IRS went a step further when it announced an 18-month pilot program that expands the scope of letter rulings to include the tax consequences of full Code Sec. 355 spinoff transactions (*Rev. Proc. 2017-52*).

Restrictions on spin-offs. Despite providing new flexibility on letter rulings, however, proposed regulations were issued that would tighten requirements by requiring that several “bright-line” tests must be met for tax-free spinoff treatment (*NPRM REG-134016-15*).

In October, the IRS announced that it is reconsidering whether favorable letter rulings should continue to be issued in four areas involving certain corporate transactions (*IRS Statement, October 13, 2017*). The changes impact rulings on worthless stock loss, Code Sec. 355 distributions and other, related transactions. Pending the outcome of its study, the IRS will insist on various characteristics in those proposed transaction before it will issue a ruling.

FBAR/FATCA

Foreign accounts. Court cases brought against reporting and withholding on foreign accounts and other assets under FBAR and FATCA rules were turned back on several fronts:

- Constitutional challenge to FBAR filing requirements (*Little, DC-N.Y., May 3, 2017*);
- Jurisdiction to allow “direct entry” into less onerous offshore Voluntary Disclosure Program (*Maze, CA-D.C., July 14, 2017*); and



Top 10 Tax Developments With Impact On 2018

The start of a new year presents a time to reflect on the past 12 months and, based on what has gone before, predict what may happen next. Here is a list of the top 10 developments from 2017 that may prove particularly important as we move forward into the new year:

<ol style="list-style-type: none"> 1 Tax Code Overhaul 2 Regulatory Resets/Reform 3 Audit Coverage 4 Affordable Care Act 5 Gig or Sharing Economy 6 Cybersecurity 	<ol style="list-style-type: none"> 7 Virtual Currency 8 Partnership Audit Rules 9 Section 179/Bonus Depreciation 10 Disaster Relief
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- Standing by U.S. Senator, citizens and expatriates to challenge FATCA, IGAs and FBAR (*Crawford, CA-6, August 18, 2017*).

Transfer pricing. The Tax Court rejected the IRS's use of a discounted cash-flow (DCF) methodology to determine a U.S. parent's determination of the value of a "buy-in payment" by a foreign subsidiary for use of pre-existing intangible assets (*Amazon.Com, Inc. & Subsidiaries, 148 TC No. 8*).

IRS Administration

Print-at-home mailbox rule. An online-generated postage label was a postmark not made by the United States Postal Service (USPS), the Tax Court found (*Pearson, 149 TC No. 20*). Nevertheless, a married couple's at-home label met the "mailbox rule."

IRS collections. Effective March 27, 2017, Offer in Compromise (OIC) applications will now be returned without further consideration in instances where the taxpayer has not filed all required tax returns, the agency explained in a post on its website.

Private tax collection. Private collection agencies are again working on some taxpayer accounts, the IRS announced in April (*IR-2017-74*).

Tax liens on family farms. The bipartisan *Family Farmer Bankruptcy Clarification Act*, signed by President Trump on October 26, 2017, allows family farms to sell off part of their assets—often with a low tax basis—to fund their Chapter 12 bankruptcy reorganization without having to treat the resulting capital gain as a priority claim of the IRS.

Disaster Relief

Disaster relief legislation. President Trump signed the *Disaster Tax Relief Act* in September. The new law provides targeted and temporary tax relief to victims of Hurricanes Harvey, Irma and Maria. Among other measures, the new law enhances the deduction for personal casualty losses, allows penalty-free access to retirement funds, creates a tax credit for employers, and permits taxpayers to use prior year income for the earned income tax credit and the child tax credit.

Hurricanes and firestorms. In response to Hurricanes Harvey, Irma and Maria, the IRS announced the postponement of certain tax deadlines for affected taxpayers. The IRS has also issued guidance to encourage leave donations and more. The IRS response to the various wildfires that have ravaged parts of California has been equally as expansive.

Casualty loss safe harbors. In December, the IRS issued safe harbor methods of calculating casualty and theft loss deductions (*Rev. Proc. 2018-8, Rev. Proc. 2018-9*). Special rules are applicable to federal-declared disaster areas. Further, the IRS targeted some flood-specific relief to victims of Hurricanes Harvey, Irma and Maria.

Foundation deterioration. The IRS announced a casualty loss safe harbor for individuals whose personal residences have deteriorating concrete foundations containing the mineral pyrrhotite.