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Discussion Draft of 'Tax Technical and Clerical Corrections Act' Released – Good News for RIC Shareholders if Passed

Rep. Kevin Brady, R-Texas, outgoing Chairman of the House Ways and Means Committee, has released the Tax Technical and Clerical Corrections Act (https://republicans-waysandmeansforms.house.gov/uploadedfiles/tax_technical_and_clerical_corrections_act_discussion_draft.pdf), a discussion draft of technical corrections to the 2017 Tax Cuts and Jobs Act (TCJA) and other recent legislation. The Joint Committee on Taxation (JCT) also has provided an explanation (https://www.jct.gov/publications.html?func=startdown&id=5154) of the discussion draft. The TCJA permits taxpayers to claim a 20 percent deduction for "qualified business income" from certain pass-through entities. Qualified business income includes certain dividends from REITs and MLPs (qualified publicly traded partnerships), but the TCJA did not provide a mechanism for RICs that invest in REITs or MLPs to pass through this deduction to their investors. The Tax Technical and Clerical Corrections Act contains a provision that would remedy this issue. The Act clarifies that an individual shareholder of a RIC take into account, for purposes of calculating the individual's qualified business income deduction, amounts reported by the RIC as qualified REIT dividends or qualified publicly traded partnership income.

IRS Releases Guidance on Trade or Business Deduction for Payment by Businesses to Reduce Certain State Taxes

The IRS released Revenue Procedure 2019-12 (https://www.irs.gov/pub/irs-drop/rp-19-12.pdf), which provides safe harbors under Section 162 for certain payments made by a C corporation or a "specified pass-through entity" to or for the use of an organization described in Section 170(c) if the C corporation or specified pass-through entity receives or expects to receive a state or local tax credit in return for such payment. (Section references are to the Internal Revenue Code of 1986, as amended (the Code).)

Section 162(a) allows a deduction for ordinary and necessary expenses paid or incurred during the tax year in carrying on any trade or business. Section 162(b) provides that no deduction is allowed under Section 162(a) for any contribution or gift that would be allowed as a deduction under Section 170 were it not for the percentage limitations, the dollar limitations or the requirements as to the time of payments set forth in that section.

Section 164(b)(6) limits an individual's deduction to $10,000 ($5,000 in the case of a married individual filing a separate return) for the aggregate amount of the following state and local taxes paid during the calendar year: (1) real property taxes; (2) personal property taxes; (3) income, war profits and excess profits taxes; and (4) general sales taxes. This limitation applies to tax years beginning after Dec. 31, 2017, and does not apply to foreign taxes described in Section 164(a)(3) or to certain taxes that are paid and incurred in carrying on a trade or business or an activity described in Section 212.

Proposed regulations issued in August 2018 generally state 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 taxpayer's charitable contribution deduction under Section 170(a). (See our prior coverage here (https://www.stradley.com/insights/publications/2018/08/tax-insights-august-29-2018).)

On Sept. 5, 2018, the IRS released an FAQ which states that the proposed regulations do not affect the availability of an ordinary and necessary business expense deduction under Section 162. (See our prior coverage here (https://www.stradley.com/insights/publications/2018/09/tax-insights-september-12-2018).) Specifically, the FAQ states that a business taxpayer making a payment to a charitable or government entity described in Section 170(c) generally is permitted to deduct the payment as an ordinary and necessary business expense under Section 162 if the payment is made with a business purpose. The FAQ also notes that the rules permitting an ordinary and necessary business expense deduction under Section 162 apply to a taxpayer engaged in carrying on a trade or business regardless of the form of the business.

The IRS has now issued a safe harbor with respect to C corporations and "specified pass-through entities." Under the C corporation safe harbor, if a C corporation makes a payment to or for the use of an organization described in Section 170(c) and receives or expects to receive a tax credit that reduces a state or local tax imposed on the C corporation in return for such payment, the C corporation may treat such payment as meeting the requirements of an ordinary and necessary business expense for purposes of Section 162(a) to the extent of the credit received or expected to be received.

The specified pass-through entity safe harbor applies to entities that qualify as specified pass-through entities that make payments as described below. An entity is considered a specified pass-through entity only if each of the following requirements is satisfied:

1. The entity is a business entity other than a C corporation that is regarded for all federal income tax purposes as separate from its owners;

2. The entity operates a trade or business within the meaning of Section 162;

3. The entity is subject to a state or local tax incurred in carrying on its trade or business **that is imposed directly on the entity**; and

4. In return for a payment to an organization described in Section 170(c), the entity receives or expects to receive a state or local tax credit that the entity applies or expects to apply to offset a state or local tax described in (3) above other than a state or local income tax.

If a specified pass-through entity makes a payment to or for the use of an organization described in Section 170(c) and receives or expects to receive a tax credit described in (4) above that the entity applies or expects to apply to offset a state or local tax described in (3) above **other than a state or local income tax**, the specified pass-through entity may treat such payment as meeting the requirements of an ordinary and necessary business expense for purposes of Section 162(a) to the extent of the credit received or expected to be received.

An example highlights the application of the rules for a specified pass-through entity. S is an S corporation engaged in a trade or business and is owned by individuals C and D. S makes a payment of $1,000 to an organization described in Section 170(c). In return for the payment, S receives or expects to receive a state tax credit equal to 80 percent of the amount of this payment ($800) to be applied to S's local real property tax liability incurred by S in carrying on its trade or business. Under applicable state and local law, the real property tax is imposed at the entity level (not the owner level). S may treat $800 of the payment as meeting the requirements of an ordinary and necessary business expense under Section 162. The treatment of the remaining $200 will depend on the facts and circumstances and is not affected by the Revenue Procedure.

Revenue Procedure 2019-12 applies to amounts described in the above safe harbor rules that are paid on or after Jan. 1, 2018.

IRS Issues Final Regulations on Public Approval of Private Activity Bonds

The IRS issued final regulations (T.D. 9845 (https://s3.amazonaws.com/public-inspection.federalregister.gov/2018-28371.pdf)) on the public approval requirement provided in Section 147(f). The requirement must be satisfied for private activity bonds to qualify for tax-exempt treatment. Under Section 103, interest received by investors in eligible state and local bonds is tax-exempt for federal income tax purposes. Interest on private activity bonds qualifies for this tax-exempt treatment only if the bonds meet the requirements for "qualified bonds" as defined in Section 141(e) and other applicable requirements provided in Section 103. Among other things, Section 141(e) requires that qualified bonds meet the public approval requirement of Section 147(f). This requires both the governmental unit that issues the bonds (or on behalf of which the bonds are issued) and a governmental unit with jurisdiction over the location of the financed project to approve an issue of private activity bonds (and the approvals are referred to as the issuer approval and the host approval, respectively). In 2017, the IRS issued proposed regulations regarding the public approval requirement. The IRS has now adopted the proposed regulations, with amendments.

IRS Issues Proposed Regulations Clarifying When Tax-Exempt Bonds Are Retired

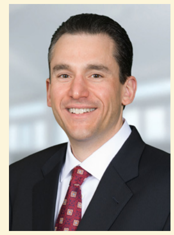
The IRS issued proposed regulations (REG-141739-08 (https://www.federalregister.gov/documents/2018/12/31/2018-28370/reissuance-of-state-or-local-bonds)) that provide retirement standards applying to tax-exempt bonds, including tender option bonds, for purposes of Section 103 and Sections 141 through 150. These retirement standards follow the guidance in Notice 2008-41, 2008-1 CB 742, with technical refinements. Issuers may apply these regulations to events and actions taken with respect to bonds that occur before the regulations are finalized.

IRS Issues Final Partnership Audit Regulations

The IRS issued final regulations (T.D. 9844 (https://www.irs.gov/pub/irs-drop/reg-136118-15.pdf)) under Sections 6221 through 6241 that implement the centralized partnership audit regime. The final regulations affect partnerships for tax years beginning after Dec. 31, 2017, and ending after Aug. 12, 2018, as well as partnerships that make the election to apply the centralized partnership audit regime to partnership tax years beginning on or after Nov. 2, 2015, and before Jan. 1, 2018.

IRS Issues Guidance on Excess Remuneration Paid by Exempt Organizations

The IRS issued Notice 2019-9 (https://www.irs.gov/pub/irs-drop/n-19-09.pdf), which provides interim guidance on Section 4960, added to the Code by the TCJA. Section 4960 imposes an excise tax on excess remuneration and excess parachute payments paid by an applicable tax-exempt organization to a covered employee. Until future guidance is issued, taxpayers may rely on the rules set out in Notice 2019-9.



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