

**TECHNICAL EXPLANATION OF THE REVENUE PROVISIONS OF THE HOUSE  
AMENDMENT TO THE SENATE AMENDMENT TO H.R. 1625  
(RULES COMMITTEE PRINT 115-66)**

Prepared by the Staff  
of the  
JOINT COMMITTEE ON TAXATION



March 22, 2018  
JCX-6-18

# CONTENTS

	<u>Page</u>
INTRODUCTION .....	1
I. REVENUE PROVISIONS .....	2
A. Extension of Expenditure Authority and Taxes Funding the Airport and Airway Trust Fund (secs. 201 and 202 of Division M of the amendment and secs. 4081, 4083, 4261, 4271, and 9502 of the Code).....	2
B. Modification of Deduction for Qualified Business Income of a Cooperative and Its Patrons (sec. 101 of Division T of the amendment and sec. 199A of the Code).....	5
C. Low-Income Housing Credit Ceiling and Average Income Test (secs. 102 and 103 of Division T of the amendment and sec. 42 of the Code) .....	28
II. TAX TECHNICAL CORRECTIONS ACT OF 2018 (DIVISION U OF THE AMENDMENT) .....	30
A. Title I – Tax Technical Corrections.....	30
B. Title II – Technical Corrections Related to Partnership Audit Rules (sec. 1101 of the Bipartisan Budget Act of 2015 and secs. 6221-6241 of the Code) .....	37
C. Title III – Other Corrections .....	52
D. Title IV – Clerical Corrections and Deadwood .....	53

## INTRODUCTION

This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, provides a technical explanation of the revenue provisions of the House amendment to the Senate amendment to H.R. 1625 (Rules Committee Print 115-66), as introduced in the House on March 21, 2018.

---

<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Technical Explanation of the Revenue Provisions of the House Amendment to the Senate Amendment to H.R. 1625 (Rules Committee Print 115-66)*, (JCX-6-18), March 22, 2018. This document can also be found on the Joint Committee on Taxation website at [www.jct.gov](http://www.jct.gov).

## I. REVENUE PROVISIONS

### A. Extension of Expenditure Authority and Taxes Funding the Airport and Airway Trust Fund (secs. 201 and 202 of Division M of the amendment and secs. 4081, 4083, 4261, 4271, and 9502 of the Code)

#### Present Law

#### Taxes dedicated to the Airport and Airway Trust Fund

Excise taxes are imposed on amounts paid for commercial air passenger and freight transportation and on fuels used in commercial and noncommercial (i.e., transportation that is not “for hire”) aviation to fund the Airport and Airway Trust Fund.<sup>2</sup> The present aviation excise taxes are as follows:

<b>Tax (and Code section)</b>	<b>Tax Rates</b>
Domestic air passengers (sec. 4261)	7.5 percent of fare, plus \$4.10 (2018) per domestic flight segment generally <sup>3</sup>
International air passengers (sec. 4261)	\$18.30 (2018) per arrival or departure <sup>4</sup>
Amounts paid for right to award free or reduced rate passenger air transportation (sec. 4261)	7.5 percent of amount paid (and the value of any other benefit provided) to an air carrier (or any related person)
Air cargo (freight) transportation (sec. 4271)	6.25 percent of amount charged for domestic transportation; no tax on international cargo transportation

---

<sup>2</sup> Air transportation through U.S. airspace that neither lands in nor takes off from a point in the United States (or the 225-mile zone, described below) is exempt from the aviation excise taxes, but the transportation provider is subject to certain “overflight fees” imposed by the Federal Aviation Administration pursuant to Congressional authorization.

<sup>3</sup> The domestic flight segment portion of the tax is adjusted annually (effective each January 1) for inflation.

<sup>4</sup> The international arrival and departure tax rate is adjusted annually for inflation. Under a special rule for Alaska and Hawaii, the tax only applies to departures at a rate of \$9.10 per departure for 2018.

Tax (and Code section)	Tax Rates
Aviation fuels (sec. 4081): <sup>5</sup> Commercial aviation Non-commercial (general) aviation: Aviation gasoline Jet fuel Fractional aircraft fuel surtax (sec. 4043)	4.3 cents per gallon  19.3 cents per gallon 21.8 cents per gallon  14.1 cents per gallon

The Airport and Airway Trust Fund excise taxes (except for 4.3 cents per gallon of the taxes on aviation fuels and the 14.1 cents per gallon fractional aircraft fuel surtax) are scheduled to expire after March 31, 2018. The 4.3-cents-per-gallon fuels tax rate is permanent. The fractional aircraft fuel surtax expires after March 31, 2021.

**Airport and Airway Trust Fund expenditure provisions**

The Airport and Airway Trust Fund was established in 1970 to finance a major portion of national aviation programs (previously funded entirely with General Fund revenues). Operation of the Trust Fund is governed by parallel provisions of the Code and authorizing statutes.<sup>6</sup> The Code provisions govern deposit of revenues into the Trust Fund and approve expenditure purposes in authorizing statutes as in effect on the date of enactment of the latest authorizing Act. The authorizing Acts provide for specific Trust Fund expenditure programs.

No expenditures are permitted to be made from the Airport and Airway Trust Fund after March 31, 2018. The purposes for which Airport and Airway Trust Fund monies are permitted to be expended are fixed as of the date of enactment of the Disaster Tax Relief and Airport and Airway Extension Act of 2017; therefore, the Code must be amended in order to authorize new Airport and Airway Trust Fund expenditure purposes.<sup>7</sup> The Code contains a specific enforcement provision to prevent expenditure of Trust Fund monies for purposes not authorized under Code section 9502.<sup>8</sup> This provision provides that, should such unapproved expenditures occur, no further aviation excise tax receipts will be transferred to the Trust Fund. Rather, the aviation taxes will continue to be imposed, but the receipts will be retained in the General Fund.

---

<sup>5</sup> Like most other taxable motor fuels, aviation fuels are subject to an additional 0.1-cent-per-gallon excise tax to fund the LUST Trust Fund.

<sup>6</sup> Sec. 9502 and 49 U.S.C. sec. 48101, et. seq.

<sup>7</sup> Sec. 9502(d).

<sup>8</sup> Sec. 9502(e)(1).

### **Explanation of Provision**

The Airport and Airway Extension Act of 2018 extends through September 30, 2018, the taxes and expenditure authority that were scheduled to expire on March 31, 2018.

### **Effective Date**

The provision is effective on the date of enactment.

**B. Modification of Deduction for Qualified Business Income  
of a Cooperative and Its Patrons  
(sec. 101 of Division T of the amendment and sec. 199A of the Code)**

**Prior Law**

**1. Treatment of taxpayers with domestic production activities income**

**In general**

Former section 199<sup>9</sup> provides a deduction from taxable income (or, in the case of an individual, adjusted gross income<sup>10</sup>) that is equal to nine percent of the lesser of the taxpayer's qualified production activities income or taxable income (determined without regard to the section 199 deduction) for the taxable year.<sup>11</sup> The amount of the deduction for a taxable year is limited to 50 percent of the W-2 wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in such taxable year.<sup>12</sup> W-2 wages are the total wages subject to wage withholding,<sup>13</sup> elective deferrals,<sup>14</sup> and deferred compensation<sup>15</sup> paid by the taxpayer with respect to employment of its employees during the calendar year ending during the taxable year of the taxpayer.<sup>16</sup> W-2 wages do not include any

---

<sup>9</sup> Section 199 was repealed by Pub. L. No. 115-97, An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, for taxable years beginning after December 31, 2017. All references to former section 199 in this document refer to section 199 as in effect before its repeal.

<sup>10</sup> For this purpose, adjusted gross income is determined after application of sections 86, 135, 137, 219, 221, 222, and 469, and without regard to the section 199 deduction. Sec. 199(d)(2).

<sup>11</sup> Sec. 199(a).

<sup>12</sup> Sec. 199(b).

<sup>13</sup> Defined in sec. 3401(a).

<sup>14</sup> Within the meaning of sec. 402(g)(3).

<sup>15</sup> Deferred compensation includes compensation deferred under section 457, as well as the amount of any designated Roth contributions (as defined in section 402A).

<sup>16</sup> Sec. 199(b). In the case of a taxpayer with a short taxable year that does not contain a calendar year ending during such short taxable year, the following amounts are treated as the W-2 wages of the taxpayer for the short taxable year: (1) wages paid during the short taxable year to employees of the qualified trade or business; (2) elective deferrals (within the meaning of section 402(g)(3)) made during the short taxable year by employees of the qualified trade or business; and (3) compensation actually deferred under section 457 during the short taxable year with respect to employees of the qualified trade or business. Amounts that are treated as W-2 wages for a taxable year are not treated as W-2 wages of any other taxable year. See Treas. Reg. sec. 1.199-2(b). In addition, in the case of a taxpayer who is an individual with otherwise qualified production activities income from sources within the commonwealth of Puerto Rico, if all the income for the taxable year is taxable under section 1 (income tax rates for individuals), the determination of W-2 wages with respect to the taxpayer's trade or business conducted in

amount that is not properly allocable to domestic production gross receipts as a qualified item of deduction.<sup>17</sup> In addition, W-2 wages do not include any amount that was not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for such return.<sup>18</sup>

In the case of oil related qualified production activities income, the deduction is reduced by three percent of the least of the taxpayer's oil related qualified production activities income, qualified production activities income, or taxable income (determined without regard to the section 199 deduction) for the taxable year.<sup>19</sup> For this purpose, oil related qualified production activities income for any taxable year is the portion of qualified production activities income attributable to the production, refining, processing, transportation, or distribution of oil, gas, or any primary product thereof<sup>20</sup> during the taxable year.

In general, qualified production activities income is equal to domestic production gross receipts reduced by the sum of: (1) the cost of goods sold that are allocable to those receipts;<sup>21</sup> and (2) other expenses, losses, or deductions which are properly allocable to those receipts.<sup>22</sup> Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property<sup>23</sup> that was manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part within the United States;<sup>24</sup> (2) any sale, exchange, or other

---

Puerto Rico is made without regard to any exclusion under the wage withholding rules (as provided in section 3401(a)(8)) for remuneration paid for services in Puerto Rico. See sec. 199(d)(8)(B).

<sup>17</sup> Sec. 199(b)(2)(B).

<sup>18</sup> Sec. 199(b)(2)(C).

<sup>19</sup> Sec. 199(d)(9).

<sup>20</sup> Within the meaning of sec. 927(a)(2)(C) as in effect before its repeal.

<sup>21</sup> For this purpose, any item or service brought into the United States is treated as acquired by purchase, and its cost is treated as not less than its value immediately after it entered the United States. A similar rule applies in determining the adjusted basis of leased or rented property where the lease or rental gives rise to domestic production gross receipts. In addition, for any property exported by the taxpayer for further manufacture, the increase in cost or adjusted basis may not exceed the difference between the value of the property when exported and the value of the property when brought back into the United States after the further manufacture. See sec. 199(c)(3)(A) and (B).

<sup>22</sup> Sec. 199(c)(1). In computing qualified production activities income, the domestic production activities deduction itself is not an allocable deduction. Sec. 199(c)(1)(B)(ii). See Treas. Reg. secs. 1.199-1 through 1.199-9 where the Secretary has prescribed rules for the proper allocation of items of income, deduction, expense, and loss for purposes of determining qualified production activities income.

<sup>23</sup> Qualifying production property generally includes any tangible personal property, computer software, and sound recordings. Sec. 199(c)(5).

<sup>24</sup> When used in the Code in a geographical sense, the term "United States" generally includes only the States and the District of Columbia. Sec. 7701(a)(9). A special rule for determining domestic production gross

disposition, or any lease, rental, or license, of any qualified film<sup>25</sup> produced by the taxpayer; (3) any sale, exchange, or other disposition, or any lease, rental, or license, of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction of real property performed in the United States by a taxpayer in the ordinary course of a construction trade or business; or (5) engineering or architectural services performed in the United States by the taxpayer for the construction of real property in the United States.<sup>26</sup>

Domestic production gross receipts do not include any gross receipts of the taxpayer derived from property leased, licensed, or rented by the taxpayer for use by any related person.<sup>27</sup> In addition, domestic production gross receipts do not include gross receipts which are derived from (1) the sale of food and beverages prepared by the taxpayer at a retail establishment, (2) the transmission or distribution of electricity, natural gas, or potable water, or (3) the lease, rental, license, sale, exchange, or other disposition of land.<sup>28</sup>

### **Special rules**

All members of an expanded affiliated group<sup>29</sup> are treated as a single corporation and the deduction is allocated among the members of the expanded affiliated group in proportion to each member's respective amount, if any, of qualified production activities income. In addition, for purposes of determining domestic production gross receipts, if all of the interests in the capital and profits of a partnership are owned by members of a single expanded affiliated group at all

---

receipts, however, provides that for taxable years beginning after December 31, 2005, and before January 1, 2018, in the case of any taxpayer with gross receipts from sources within the Commonwealth of Puerto Rico, the term "United States" includes the Commonwealth of Puerto Rico, but only if all of the taxpayer's Puerto Rico-sourced gross receipts are taxable under the Federal income tax for individuals or corporations for such taxable year. Sec. 199(d)(8)(A) and (C). In computing the 50-percent wage limitation, the taxpayer is permitted to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico. Sec. 199(d)(8)(B).

<sup>25</sup> Qualified film includes any motion picture film or videotape (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of the film (including compensation in the form of residuals and participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers. Sec. 199(c)(6).

<sup>26</sup> Sec. 199(c)(4)(A).

<sup>27</sup> Sec. 199(c)(7). For this purpose, a person is treated as related to another person if such persons are treated as a single employer under subsection (a) or (b) of section 52 or subsection (m) or (o) of section 414, except that determinations under subsections (a) and (b) of section 52 are made without regard to section 1563(b).

<sup>28</sup> Sec. 199(c)(4)(B).

<sup>29</sup> For this purpose, an expanded affiliated group is an affiliated group as defined in section 1504(a) determined (i) by substituting "more than 50 percent" for "more than 80 percent" each place it appears, and (ii) without regard to paragraphs (2) and (4) of section 1504(b). See sec. 199(d)(4)(B).

times during the taxable year of such partnership, the partnership and all members of such group are treated as a single taxpayer during such period.<sup>30</sup>

For a tax-exempt taxpayer subject to tax on its unrelated business taxable income by section 511, the section 199 deduction is determined by substituting unrelated business taxable income for taxable income where applicable.<sup>31</sup>

The section 199 deduction is determined by only taking into account items that are attributable to the actual conduct of a trade or business.<sup>32</sup>

### **Partnerships and S corporations**

With regard to the domestic production activities income of a partnership or S corporation, the deduction is determined at the partner or shareholder level. Each partner or shareholder generally takes into account such person's allocable share of the components of the calculation (including domestic production gross receipts; the cost of goods sold allocable to such receipts; and other expenses, losses, or deductions allocable to such receipts) from the partnership or S corporation, as well as any items relating to the partner or shareholder's own qualified production activities income, if any.<sup>33</sup>

In applying the wage limitation, each partner or shareholder is treated as having been allocated wages from the partnership or S corporation in an amount that is equal to such person's allocable share of W-2 wages.<sup>34</sup>

### **Specified agricultural and horticultural cooperatives**

#### **In general**

With regard to specified agricultural and horticultural cooperatives, section 199 provides the same treatment of qualified production activities income derived from agricultural or horticultural products that are manufactured, produced, grown, or extracted by such cooperatives,<sup>35</sup> as it provides for qualified production activities income of other taxpayers,

---

<sup>30</sup> Sec. 199(d)(4)(D).

<sup>31</sup> Sec. 199(d)(7).

<sup>32</sup> Sec. 199(d)(5).

<sup>33</sup> Sec. 199(d)(1)(A).

<sup>34</sup> In the case of a trust or estate, the components of the calculation are apportioned between (and among) the beneficiaries and the fiduciary. See sec. 199(d)(1)(B) and Treas. Reg. sec. 1.199-5(d) and (e).

<sup>35</sup> For this purpose, agricultural or horticultural products also include fertilizer, diesel fuel, and other supplies used in agricultural or horticultural production that are manufactured, produced, grown, or extracted by the cooperative. See Treas. Reg. sec. 1.199-6(f).

including non-specified cooperatives (*i.e.*, the cooperative may claim a deduction for qualified production activities income). The cooperative is treated as having manufactured, produced, grown, or extracted in whole or significant part any qualifying production property marketed by the cooperative if such items were manufactured, produced, grown, or extracted in whole or significant part by its patrons.<sup>36</sup> In addition, the cooperative is treated as having manufactured, produced, grown, or extracted agricultural products with respect to which the cooperative performs storage, handling, or other processing activities (other than transportation activities) within the United States related to the sale, exchange, or other disposition of agricultural products, provided the products are consumed in connection with or incorporated into the manufacturing, production, growth, or extraction of qualifying production property (whether or not by the cooperative).<sup>37</sup> Finally, for purposes of determining the cooperative's section 199 deduction, qualified production activities income and taxable income are determined without regard to any deduction allowable under section 1382(b) and (c) (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions) for the taxable year.<sup>38</sup>

#### Definition of a specified agricultural or horticultural cooperative

A specified agricultural or horticultural cooperative is an organization to which part I of subchapter T applies that is engaged in (a) the manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural product, or (b) the marketing of agricultural or horticultural products that its patrons have so manufactured, produced, grown, or extracted.<sup>39</sup>

#### Allocation of the cooperative's deduction to patrons

Any patron that receives a qualified payment from a specified agricultural or horticultural cooperative is allowed as a deduction for the taxable year in which such payment is received an amount equal to the portion of the cooperative's deduction for qualified production activities income that is (i) allowed with respect to the portion of the qualified production activities income to which such payment is attributable, and (ii) identified by the cooperative in a written notice mailed to the patron during the payment period described in section 1382(d).<sup>40</sup> A qualified payment is any amount that (i) is described in paragraph (1) or (3) of section 1385(a) (*i.e.*,

---

<sup>36</sup> Sec. 199(d)(3)(D) and Treas. Reg. sec. 1.199-6(d).

<sup>37</sup> See Treas. Reg. sec. 1.199-3(e)(1).

<sup>38</sup> See sec. 199(d)(3)(C) and Treas. Reg. sec. 1.199-6(c).

<sup>39</sup> Sec. 199(d)(3)(F). For this purpose, agricultural or horticultural products also include fertilizer, diesel fuel and other supplies used in agricultural or horticultural production that are manufactured, produced, grown, or extracted by the cooperative. See Treas. Reg. sec. 1.199-6(f).

<sup>40</sup> Sec. 199(d)(3)(A) and Treas. Reg. sec. 1.199-6(a). The written notice must be mailed by the cooperative to its patrons no later than the 15<sup>th</sup> day of the ninth month following the close of the taxable year. The cooperative must report the amount of the patron's section 199 deduction on Form 1099-PATR, "Taxable Distributions Received From Cooperatives," issued to the patron. Treas. Reg. sec. 1.199-6(g).

patronage dividends and per-unit retain allocations), (ii) is received by an eligible patron from a specified agricultural or horticultural cooperative, and (iii) is attributable to qualified production activities income with respect to which a deduction is allowed to such cooperative.<sup>41</sup>

The cooperative cannot reduce its income under section 1382 for any deduction allowable to its patrons under this rule (*i.e.*, the cooperative must reduce its deductions allowed for certain payments to its patrons in an amount equal to the section 199 deduction allocated to its patrons).<sup>42</sup>

## Present Law

### **1. Treatment of taxpayers other than corporations**

#### **In general**

##### Individual income tax rates

To determine regular tax liability, an individual taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases. Separate rate schedules apply based on an individual's filing status (*i.e.*, single, head of household, married filing jointly, or married filing separately). For 2018, the regular individual income tax rate schedule provides rates of 10, 12, 22, 24, 32, 35, and 37 percent.

##### Partnerships

Partnerships generally are treated for Federal income tax purposes as pass-through entities not subject to tax at the entity level.<sup>43</sup> Items of income (including tax-exempt income), gain, loss, deduction, and credit of the partnership are taken into account by the partners in computing their income tax liability (based on the partnership's method of accounting and regardless of whether the income is distributed to the partners).<sup>44</sup> A partner's deduction for partnership losses is limited to the partner's adjusted basis in its partnership interest.<sup>45</sup> Losses

---

<sup>41</sup> Sec. 199(d)(3)(E). For this purpose, patronage dividends and per-unit retain allocations include any advances on patronage and per-unit retains paid in money during the taxable year. Treas. Reg. sec. 1.199-6(e).

<sup>42</sup> Sec. 199(d)(3)(B) and Treas. Reg. sec. 1.199-6(b).

<sup>43</sup> Sec. 701.

<sup>44</sup> Sec. 702(a).

<sup>45</sup> Sec. 704(d). In addition, passive loss and at-risk limitations limit the extent to which certain types of income can be offset by partnership deductions (sections 469 and 465). These limitations do not apply to corporate partners (except certain closely-held corporations) and may not be important to individual partners who have partner-level passive income from other investments.

not allowed as a result of that limitation generally are carried forward to the next year. A partner's adjusted basis in the partnership interest generally equals the sum of (1) the partner's capital contributions to the partnership, (2) the partner's distributive share of partnership income, and (3) the partner's share of partnership liabilities, less (1) the partner's distributive share of losses allowed as a deduction and certain nondeductible expenditures, and (2) any partnership distributions to the partner.<sup>46</sup> Partners generally may receive distributions of partnership property without recognition of gain or loss, subject to some exceptions.<sup>47</sup>

Partnerships may allocate items of income, gain, loss, deduction, and credit among the partners, provided the allocations have substantial economic effect.<sup>48</sup> In general, an allocation has substantial economic effect to the extent the partner to which the allocation is made receives the economic benefit or bears the economic burden of such allocation and the allocation substantially affects the dollar amounts to be received by the partners from the partnership independent of tax consequences.<sup>49</sup>

State laws of every State provide for limited liability companies<sup>50</sup> ("LLCs"), which are neither partnerships nor corporations under applicable State law, but which are generally treated as partnerships for Federal tax purposes.<sup>51</sup>

A publicly traded partnership generally is treated as a corporation for Federal tax purposes.<sup>52</sup> For this purpose, a publicly traded partnership means any partnership if interests in the partnership are traded on an established securities market or interests in the partnership are readily tradable on a secondary market (or the substantial equivalent thereof).<sup>53</sup>

---

<sup>46</sup> Sec. 705.

<sup>47</sup> Sec. 731. Gain or loss may nevertheless be recognized, for example, on the distribution of money or marketable securities, distributions with respect to contributed property, or in the case of disproportionate distributions (which can result in ordinary income).

<sup>48</sup> Sec. 704(b)(2).

<sup>49</sup> Treas. Reg. sec. 1.704-1(b)(2).

<sup>50</sup> The first LLC statute was enacted in Wyoming in 1977. All States (and the District of Columbia) now have an LLC statute, though the tax treatment of LLCs for State tax purposes may differ.

<sup>51</sup> Any domestic nonpublicly traded unincorporated entity with two or more members generally is treated as a partnership for federal income tax purposes, while any single-member domestic unincorporated entity generally is treated as disregarded for Federal income tax purposes (*i.e.*, treated as not separate from its owner). Instead of the applicable default treatment, however, an LLC may elect to be treated as a corporation for Federal income tax purposes. Treas. Reg. sec. 301.7701-3 (known as the "check-the-box" regulations).

<sup>52</sup> Sec. 7704(a).

<sup>53</sup> Sec. 7704(b).

An exception from corporate treatment is provided for certain publicly traded partnerships, 90 percent or more of whose gross income is qualifying income.<sup>54</sup>

### S corporations

For Federal income tax purposes, an S corporation<sup>55</sup> generally is not subject to tax at the corporate level.<sup>56</sup> Items of income (including tax-exempt income), gain, loss, deduction, and credit of the S corporation are taken into account by the S corporation shareholders in computing their income tax liabilities (based on the S corporation's method of accounting and regardless of whether the income is distributed to the shareholders). A shareholder's deduction for corporate losses is limited to the sum of the shareholder's adjusted basis in its S corporation stock and the indebtedness of the S corporation to such shareholder. Losses not allowed as a result of that limitation generally are carried forward to the next year. A shareholder's adjusted basis in the S corporation stock generally equals the sum of (1) the shareholder's capital contributions to the S corporation and (2) the shareholder's pro rata share of S corporation income, less (1) the shareholder's pro rata share of losses allowed as a deduction and certain nondeductible expenditures, and (2) any S corporation distributions to the shareholder.<sup>57</sup>

In general, an S corporation shareholder is not subject to tax on corporate distributions unless the distributions exceed the shareholder's basis in the stock of the corporation.

---

<sup>54</sup> Sec. 7704(c)(2). Qualifying income is defined to include interest, dividends, and gains from the disposition of a capital asset (or of property described in section 1231(b)) that is held for the production of income that is qualifying income. Sec. 7704(d). Qualifying income also includes rents from real property, gains from the sale or other disposition of real property, and income and gains from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber), industrial source carbon dioxide, or the transportation or storage of certain fuel mixtures, alternative fuel, alcohol fuel, or biodiesel fuel. Qualifying income also includes income and gains from commodities (not described in section 1221(a)(1)) or futures, options, or forward contracts with respect to such commodities (including foreign currency transactions of a commodity pool) where a principal activity of the partnership is the buying and selling of such commodities, futures, options, or forward contracts. However, the exception for partnerships with qualifying income does not apply to any partnership resembling a mutual fund (*i.e.*, that would be described in section 851(a) if it were a domestic corporation), which includes a corporation registered under the Investment Company Act of 1940 (Pub. L. No. 76-768 (1940)) as a management company or unit investment trust. Sec. 7704(c)(3).

<sup>55</sup> An S corporation is so named because its Federal tax treatment is governed by subchapter S of the Code.

<sup>56</sup> Secs. 1363 and 1366.

<sup>57</sup> Sec. 1367. If any amount that would reduce the adjusted basis of a shareholder's S corporation stock exceeds the amount that would reduce that basis to zero, the excess is applied to reduce (but not below zero) the shareholder's basis in any indebtedness of the S corporation to the shareholder. If, after a reduction in the basis of such indebtedness, there is an event that would increase the adjusted basis of the shareholder's S corporation stock, such increase is instead first applied to restore the reduction in the basis of the shareholder's indebtedness. Sec. 1367(b)(2).

To be eligible to elect S corporation status, a corporation may not have more than 100 shareholders and may not have more than one class of stock.<sup>58</sup> Only individuals (other than nonresident aliens), certain tax-exempt organizations, and certain trusts and estates are permitted shareholders of an S corporation.

### Sole proprietorships

Unlike a C corporation, partnership, or S corporation, a business conducted as a sole proprietorship is not treated as an entity distinct from its owner for Federal income tax purposes.<sup>59</sup> Rather, the business owner is taxed directly on business income, and files Schedule C (sole proprietorships generally), Schedule E (rental real estate and royalties), or Schedule F (farms) with his or her individual tax return. Furthermore, transfer of a sole proprietorship is treated as a transfer of each individual asset of the business. Nonetheless, a sole proprietorship is treated as an entity separate from its owner for employment tax purposes,<sup>60</sup> for certain excise taxes,<sup>61</sup> and certain information reporting requirements.<sup>62</sup>

### **Taxpayers other than corporations with qualified business income**

For taxable years beginning after December 31, 2017, and before January 1, 2026, an individual taxpayer generally may deduct 20 percent of qualified business income from a partnership, S corporation, or sole proprietorship, as well as 20 percent of aggregate qualified REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income.<sup>63</sup> Limitations based on W-2 wages and capital investment phase in above a threshold amount of taxable income.<sup>64</sup> A disallowance of the deduction on income of specified service trades or businesses also phases in above the threshold amount of taxable income.

---

<sup>58</sup> Sec. 1361. For this purpose, a husband and wife and all members of a family are treated as one shareholder. Sec. 1361(c)(1).

<sup>59</sup> A single-member unincorporated entity is disregarded for Federal income tax purposes, unless its owner elects to be treated as a C corporation. Treas. Reg. sec. 301.7701-3(b)(1)(ii). Sole proprietorships often are conducted through legal entities for nontax reasons. While sole proprietorships generally may have no more than one owner, a married couple that files a joint return and jointly owns and operates a business may elect to have that business treated as a sole proprietorship under section 761(f).

<sup>60</sup> Treas. Reg. sec. 301.7701-2(c)(2)(iv).

<sup>61</sup> Treas. Reg. sec. 301.7701-2(c)(2)(v).

<sup>62</sup> Treas. Reg. sec. 301.7701-2(c)(2)(vi).

<sup>63</sup> Sec. 199A. Eligible taxpayers also include fiduciaries and beneficiaries of trusts and estates with qualified business income.

<sup>64</sup> For this purpose, taxable income is computed without regard to the 20-percent deduction. Sec. 199A(e)(1).

## Qualified business income

### In general

Qualified business income is determined for each qualified trade or business of the taxpayer. For any taxable year, qualified business income means the net amount of qualified items of income, gain, deduction, and loss with respect to the qualified trade or business of the taxpayer. The determination of qualified items of income, gain, deduction, and loss takes into account such items only to the extent included or allowed in the determination of taxable income for the year.

Items are treated as qualified items of income, gain, deduction, and loss only to the extent they are effectively connected with the conduct of a trade or business within the United States.<sup>65</sup> In the case of an individual with qualified business income from sources within the commonwealth of Puerto Rico, if all such income for the taxable year is taxable under section 1 (income tax rates for individuals), then the term “United States” is considered to include Puerto Rico for purposes of determining the individual’s qualified business income.<sup>66</sup>

Certain items are not qualified items of income, gain, deduction, or loss.<sup>67</sup> Specifically, qualified items of income, gain, deduction, and loss do not include (1) any item taken into account in determining net capital gain or net capital loss, (2) dividends, income equivalent to a dividend, or payments in lieu of dividends, (3) interest income other than that which is properly allocable to a trade or business, (4) the excess of gain over loss from commodities transactions other than (i) those entered into in the normal course of the trade or business or (ii) with respect to stock in trade or property held primarily for sale to customers in the ordinary course of the trade or business, property used in the trade or business, or supplies regularly used or consumed in the trade or business, (5) the excess of foreign currency gains over foreign currency losses from section 988 transactions other than transactions directly related to the business needs of the business activity, (6) net income from notional principal contracts other than clearly identified hedging transactions that are treated as ordinary (*i.e.*, not treated as capital assets), and (7) any amount received from an annuity that is not received in connection with the trade or business. Qualified items do not include any item of deduction or loss properly allocable to any of the preceding items.

If the net amount of qualified business income from all qualified trades or businesses during the taxable year is a loss, then such loss is carried forward and in the next taxable year is

---

<sup>65</sup> For this purpose, section 864(c) is applied by substituting “qualified trade or business (within the meaning of section 199A)” for “nonresident alien individual or a foreign corporation” or for “a foreign corporation,” each place they appear. Sec. 199A(c)(3)(A).

<sup>66</sup> Sec. 199A(f)(1)(C).

<sup>67</sup> See sec. 199A(c)(3)(B).

treated as a loss from a qualified trade or business.<sup>68</sup> Any deduction that would otherwise be allowed in a subsequent taxable year with respect to the taxpayer's qualified trades or businesses is reduced by 20 percent of any carryover qualified business loss.

#### Reasonable compensation and guaranteed payments

Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer.<sup>69</sup> Similarly, qualified business income does not include any guaranteed payment for services rendered with respect to the trade or business,<sup>70</sup> and, to the extent provided in regulations, does not include any amount paid or incurred by a partnership to a partner, acting other than in his or her capacity as a partner, for services.<sup>71</sup>

#### Qualified trade or business

A qualified trade or business means any trade or business other than a specified service trade or business and other than the trade or business of performing services as an employee.<sup>72</sup>

#### Specified service trade or business

A specified service trade or business means any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, or which involves the performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities.<sup>73</sup> For this purpose a security and a commodity have the meanings provided in the rules for the mark-to-market accounting method for dealers in securities (section 475(c)(2) and (e)(2), respectively).

The exclusion from the definition of a qualified trade or business for specified service trades or businesses phases in for a taxpayer with taxable income in excess of a threshold amount. The threshold amount is \$157,500 (200 percent of that amount, or \$315,000, in the case of a joint return) (together, the "threshold amount"), adjusted for inflation in taxable years

---

<sup>68</sup> Sec. 199A(c)(2).

<sup>69</sup> Sec. 199A(c)(4).

<sup>70</sup> Described in sec. 707(c).

<sup>71</sup> Described in sec. 707(a).

<sup>72</sup> Sec. 199A(d)(1).

<sup>73</sup> Sec. 199A(d)(2).

beginning after 2018.<sup>74</sup> The exclusion from the definition of a qualified trade or business for specified service trades or businesses is fully phased in for a taxpayer with taxable income in excess of the threshold amount plus \$50,000 (\$100,000 in the case of a joint return).<sup>75</sup>

### Tentative deductible amount for a qualified trade or business

#### In general

For a taxpayer with taxable income below the threshold amount, the deductible amount for each qualified trade or business is equal to 20 percent of the qualified business income with respect to the trade or business.<sup>76</sup> For a taxpayer with taxable income above the threshold, the taxpayer is allowed a deductible amount for each qualified trade or business equal to the lesser of (1) 20 percent of the qualified business income with respect to such trade or business, or (2) the greater of (a) 50 percent of the W-2 wages paid with respect to the qualified trade or business, or (b) the sum of 25 percent of the W-2 wages paid with respect to the qualified trade or business plus 2.5 percent of the unadjusted basis, immediately after acquisition, of all qualified property of the qualified trade or business.<sup>77</sup>

#### Limitations based on W-2 wages and capital

The wage and capital limitations phase in for a taxpayer with taxable income in excess of the threshold amount.<sup>78</sup> The wage and capital limitations apply fully for a taxpayer with taxable income in excess of the threshold amount plus \$50,000 (\$100,000 in the case of a joint return).

W-2 wages are the total wages subject to wage withholding,<sup>79</sup> elective deferrals,<sup>80</sup> and deferred compensation<sup>81</sup> paid by the qualified trade or business with respect to employment of its employees during the calendar year ending during the taxable year of the taxpayer.<sup>82</sup> In the case

---

<sup>74</sup> Sec. 199A(e)(2).

<sup>75</sup> See sec. 199A(d)(3).

<sup>76</sup> Sec. 199A(b)(3).

<sup>77</sup> Sec. 199A(b)(2).

<sup>78</sup> See sec. 199A(b)(3)(B).

<sup>79</sup> Defined in sec. 3401(a).

<sup>80</sup> Within the meaning of sec. 402(g)(3).

<sup>81</sup> Deferred compensation includes compensation deferred under section 457, as well as the amount of any designated Roth contributions (as defined in section 402A).

<sup>82</sup> Sec. 199A(b)(4). In the case of a taxpayer with a short taxable year that does not contain a calendar year ending during such short taxable year, the following amounts are treated as the W-2 wages of the taxpayer for the short taxable year: (1) wages paid during the short taxable year to employees of the qualified trade or business; (2) elective deferrals (within the meaning of section 402(g)(3)) made during the short taxable year by employees of the

of a taxpayer who is an individual with otherwise qualified business income from sources within the commonwealth of Puerto Rico, if all the income for the taxable year is taxable under section 1 (income tax rates for individuals), the determination of W-2 wages with respect to the taxpayer's trade or business conducted in Puerto Rico is made without regard to any exclusion under the wage withholding rules<sup>83</sup> for remuneration paid for services in Puerto Rico. W-2 wages do not include any amount that is not properly allocable to qualified business income as a qualified item of deduction.<sup>84</sup> In addition, W-2 wages do not include any amount that was not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for such return.<sup>85</sup>

Qualified property means tangible property of a character subject to depreciation under section 167 that is held by, and available for use in, the qualified trade or business at the close of the taxable year, which is used at any point during the taxable year in the production of qualified business income, and for which the depreciable period has not ended before the close of the taxable year.<sup>86</sup> The depreciable period with respect to qualified property of a taxpayer means the period beginning on the date the property is first placed in service by the taxpayer and ending on the later of (a) the date that is 10 years after the date the property is first placed in service, or (b) the last day of the last full year in the applicable recovery period that would apply to the property under section 168 (determined without regard to section 168(g)).

#### Partnerships and S corporations

In the case of a partnership or S corporation, the section 199A deduction is determined at the partner or shareholder level. Each partner in a partnership takes into account the partner's allocable share of each qualified item of income, gain, deduction, and loss, and is treated as having W-2 wages and unadjusted basis of qualified property for the taxable year equal to the partner's allocable share of W-2 wages and unadjusted basis of qualified property of the partnership. The partner's allocable share of W-2 wages and unadjusted basis of qualified property are required to be determined in the same manner as the partner's allocable share of wage expenses and depreciation, respectively. Similarly, each shareholder of an S corporation takes into account the shareholder's pro rata share of each qualified item of income, gain, deduction, and loss of the S corporation, and is treated as having W-2 wages and unadjusted

---

qualified trade or business; and (3) compensation actually deferred under section 457 during the short taxable year with respect to employees of the qualified trade or business. Amounts that are treated as W-2 wages for a taxable year are not treated as W-2 wages of any other taxable year. See Conference Report to accompany H.R. 1, Tax Cuts and Jobs Act, H.R. Rep. No. 115-466, December 15, 2017, p. 217.

<sup>83</sup> As provided in sec. 3401(a)(8).

<sup>84</sup> Sec. 199A(b)(4)(B).

<sup>85</sup> Sec. 199A(b)(4)(C).

<sup>86</sup> Sec. 199A(b)(6).

basis of qualified property for the taxable year equal to the shareholder's pro rata share of W-2 wages and unadjusted basis of qualified property of the S corporation.

Qualified REIT dividends, cooperative dividends, and publicly traded partnership income

A deduction is allowed for 20 percent of the taxpayer's aggregate amount of qualified REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income for the taxable year.<sup>87</sup>

Qualified REIT dividends do not include any portion of a dividend received from a REIT that is a capital gain dividend<sup>88</sup> or a qualified dividend.<sup>89</sup>

A qualified cooperative dividend means any patronage dividend,<sup>90</sup> per-unit retain allocation,<sup>91</sup> qualified written notice of allocation,<sup>92</sup> or any other similar amount, provided such amount is includible in gross income and is received from either (1) a tax-exempt organization described in section 501(c)(12)<sup>93</sup> or a taxable or tax-exempt cooperative that is described in section 1381(a), or (2) a taxable cooperative governed by tax rules applicable to cooperatives before the enactment of subchapter T of the Code in 1962.<sup>94</sup>

Qualified publicly traded partnership income means (with respect to any qualified trade or business of the taxpayer) the sum of (a) the net amount of the taxpayer's allocable share of each qualified item of income, gain, deduction, and loss of the partnership from a publicly traded partnership not treated as a corporation,<sup>95</sup> and (b) gain recognized by the taxpayer on disposition

---

<sup>87</sup> See sec. 199A(a) and (b).

<sup>88</sup> Defined in sec. 857(b)(3).

<sup>89</sup> Defined in sec. 1(h)(11). See sec. 199A(e)(3).

<sup>90</sup> Defined in sec. 1388(a).

<sup>91</sup> Defined in sec. 1388(f).

<sup>92</sup> Defined in sec. 1388(c).

<sup>93</sup> Organizations described in section 501(c)(12) are benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses. Sec. 501(c)(12)(A).

<sup>94</sup> Sec. 199A(e)(4).

<sup>95</sup> Such items must be effectively connected with a U.S. trade or business, be included or allowed in determining taxable income for the taxable year, and not constitute excepted enumerated investment-type income. Such items do not include the taxpayer's reasonable compensation, guaranteed payments for services, or (to the extent provided in regulations) section 707(a) payments for services.

of its interest in such partnership that is treated as ordinary income (for example, by reason of section 751).<sup>96</sup>

### Determination of the taxpayer's deduction

The taxpayer's deduction for qualified business income for the taxable year is equal to the sum of (1) the lesser of (a) the combined qualified business income amount for the taxable year, or (b) an amount equal to 20 percent of taxable income (reduced by any net capital gain<sup>97</sup> and qualified cooperative dividends), plus (2) the lesser of (a) 20 percent of qualified cooperative dividends, or (b) taxable income (reduced by net capital gain). This sum may not exceed the taxpayer's taxable income for the taxable year (reduced by net capital gain).<sup>98</sup> The combined qualified business income amount for the taxable year is the sum of the deductible amounts determined for each qualified trade or business carried on by the taxpayer and 20 percent of the taxpayer's qualified REIT dividends and qualified publicly traded partnership income.<sup>99</sup>

The taxpayer's deduction for qualified business income is not allowed in computing adjusted gross income; instead, the deduction is allowed in computing taxable income.<sup>100</sup> The deduction is available to both individuals who do itemize their deductions and individuals who do not itemize their deductions.<sup>101</sup>

## **2. Treatment of cooperatives and their patrons**

### **In general**

Certain corporations are eligible to be treated as cooperatives and taxed under the special rules of subchapter T of the Code.<sup>102</sup> In general, the subchapter T rules apply to any corporation operating on a cooperative basis (except mutual savings banks, insurance companies, most tax-exempt organizations, and certain utilities).

For Federal income tax purposes, a cooperative subject to the cooperative tax rules of subchapter T generally computes its income as if it were a taxable corporation, except that, in determining its taxable income, the cooperative does not take into account amounts paid for the taxable year as (1) patronage dividends, to the extent paid in money, qualified written notices of

---

<sup>96</sup> Sec. 199A(e)(5).

<sup>97</sup> Defined in sec. 1(h).

<sup>98</sup> Sec. 199A(a).

<sup>99</sup> Sec. 199A(b)(1).

<sup>100</sup> Sec. 62(a).

<sup>101</sup> Sec. 63(b) and (d).

<sup>102</sup> Secs. 1381-1388.

allocation,<sup>103</sup> or other property (except nonqualified written notices of allocation)<sup>104</sup> with respect to patronage occurring during such taxable year, and (2) per-unit retain allocations, to the extent paid in money, qualified per-unit retain certificates,<sup>105</sup> or other property (except nonqualified per-unit retain certificates)<sup>106</sup> with respect to marketing occurring during such taxable year.<sup>107</sup>

Patronage dividends are amounts paid to a patron (1) on the basis of quantity or value of business done with or for such patron, (2) under an obligation of the cooperative to pay such amount that existed before the cooperative received the amount so paid, and (3) which are determined by reference to the net earnings of the cooperative from business done with or for its patrons.<sup>108</sup> Per-unit retain allocations are allocations to a patron with respect to products marketed for him, the amount of which is fixed without reference to the net earnings of the organization pursuant to an agreement between the organization and the patron.<sup>109</sup>

Because a patron of a cooperative that receives patronage dividends or per-unit retain allocations generally must include such amounts in gross income,<sup>110</sup> excluding patronage dividends and per-unit retain allocations paid by the cooperative from the cooperative's taxable income in effect allows the cooperative to be a conduit with respect to profits derived from transactions with its patrons.

### **Specified agricultural or horticultural cooperatives with qualified business income**

For taxable years beginning after December 31, 2017, and before January 1, 2026, a deduction is allowed to any specified agricultural or horticultural cooperative equal to the lesser of (a) 20 percent of the excess (if any) of the cooperative's gross income over the qualified cooperative dividends paid during the taxable year for the taxable year, or (b) the greater of 50 percent of the W-2 wages paid by the cooperative with respect to its trade or business or the sum of 25 percent of the W-2 wages of the cooperative with respect to its trade or business plus 2.5 percent of the unadjusted basis immediately after acquisition of qualified property of the

---

<sup>103</sup> As defined in sec. 1388(c).

<sup>104</sup> As defined in sec. 1388(d).

<sup>105</sup> As defined in sec. 1388(h).

<sup>106</sup> As defined in sec. 1388(i).

<sup>107</sup> Sec. 1382(b)(1) and (3). In determining its taxable income, the cooperative also does not take into account amounts paid in money or other property in redemption of a nonqualified written notice of allocation which was paid as a patronage dividend during the payment period for the taxable year during which the patronage occurred, or in redemption of a nonqualified per-unit retain certificate which was paid as a per-unit retain allocation during the payment period for the taxable year during which the marketing occurred. Sec. 1382(b)(2) and (4).

<sup>108</sup> Sec. 1388(a).

<sup>109</sup> Sec. 1388(f).

<sup>110</sup> Sec. 1385(a)(1) and (3).

cooperative.<sup>111</sup> The cooperative's section 199A(g) deduction may not exceed its taxable income<sup>112</sup> for the taxable year.

A specified agricultural or horticultural cooperative is an organization to which part I of subchapter T applies that is engaged in (a) the manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural product, (b) the marketing of agricultural or horticultural products that its patrons have so manufactured, produced, grown, or extracted, or (c) the provision of supplies, equipment, or services to farmers or organizations described in the foregoing.

### **Explanation of Provision**

#### **1. Treatment of specified agricultural or horticultural cooperatives**

##### **Deduction for qualified production activities income**

The proposal modifies the deduction for qualified business income of a specified agricultural or horticultural cooperative under section 199A(g) to instead provide a deduction for qualified production activities income of a specified agricultural or horticultural cooperative that is similar to the deduction for qualified production activities income under former section 199.

The proposal provides a deduction from taxable income that is equal to nine percent of the lesser of the cooperative's qualified production activities income or taxable income (determined without regard to the cooperative's section 199A(g) deduction and any deduction allowable under section 1382(b) and (c) (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions)) for the taxable year. The amount of the deduction for a taxable year is limited to 50 percent of the W-2 wages paid by the cooperative during the calendar year that ends in such taxable year. For this purpose, W-2 wages are determined in the same manner as under the other provisions of section 199A, except that such wages do not include any amount that is not properly allocable to domestic production gross receipts.<sup>113</sup>

In the case of oil related qualified production activities income, the proposal provides that the section 199A(g) deduction is reduced by three percent of the least of the cooperative's oil related qualified production activities income, qualified production activities income, or taxable income (determined without regard to the cooperative's section 199A(g) deduction and any deduction allowable under section 1382(b) and (c) (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions)) for the taxable year. For this purpose, oil

---

<sup>111</sup> Sec. 199A(g).

<sup>112</sup> For this purpose, taxable income is computed without regard to the cooperative's deduction under section 199A(g).

<sup>113</sup> Under the proposal, because Puerto Rico is not treated as part of the United States for purposes of determining domestic production gross receipts under section 199A(g), W-2 wages do not include any remuneration paid for services in Puerto Rico.

related qualified production activities income for any taxable year is the portion of qualified production activities income attributable to the production, refining, processing, transportation, or distribution of oil, gas, or any primary product thereof<sup>114</sup> during the taxable year.

In general, qualified production activities income is equal to domestic production gross receipts reduced by the sum of: (1) the cost of goods sold that are allocable to such receipts;<sup>115</sup> and (2) other expenses, losses, or deductions that are properly allocable to such receipts.<sup>116</sup> Domestic production gross receipts generally are gross receipts of the cooperative that are derived from any lease, rental, license, sale, exchange, or other disposition of any agricultural or horticultural product<sup>117</sup> that was manufactured, produced, grown, or extracted by the cooperative in whole or in significant part within the United States.<sup>118</sup> The cooperative is treated as having manufactured, produced, grown, or extracted in whole or significant part any agricultural or horticultural products marketed by the cooperative if such items were manufactured, produced, grown, or extracted in whole or significant part by its patrons.

Domestic production gross receipts do not include any gross receipts of the cooperative derived from property leased, licensed, or rented by the taxpayer for use by any related person.<sup>119</sup> In addition, domestic production gross receipts do not include gross receipts that are derived from the lease, rental, license, sale, exchange, or other disposition of land.

---

<sup>114</sup> Within the meaning of section 927(a)(2)(C) as in effect before its repeal.

<sup>115</sup> For this purpose, any item or service brought into the United States is treated as acquired by purchase, and its cost is treated as not less than its value immediately after it entered the United States. A similar rule applies in determining the adjusted basis of leased or rented property where the lease or rental gives rise to domestic production gross receipts. In addition, for any property exported by the cooperative for further manufacture, the increase in cost or adjusted basis may not exceed the difference between the value of the property when exported and the value of the property when brought back into the United States after the further manufacture.

<sup>116</sup> In computing qualified production activities income, the section 199A(g) deduction itself is not an allocable deduction. As under former section 199, the cooperative's qualified production activities income is determined without regard to any deduction allowable under section 1382(b) and (c) (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions). See Treas. Reg. sec. 1.199-6(c).

<sup>117</sup> Consistent with former section 199, it is intended that agricultural or horticultural products also include fertilizer, diesel fuel, and other supplies used in agricultural or horticultural production that are manufactured, produced, grown, or extracted by the cooperative. See Treas. Reg. sec. 1.199-6(f).

<sup>118</sup> Consistent with former section 199, it is intended that domestic production gross receipts include gross receipts of a cooperative derived from any sale, exchange, or other disposition of agricultural products with respect to which the cooperative performs storage, handling, or other processing activities (other than transportation activities) within the United States, provided such products are consumed in connection with, or incorporated into, the manufacturing, production, growth, or extraction of agricultural or horticultural products (whether or not by the cooperative). See Treas. Reg. sec. 1.199-3(e)(1).

<sup>119</sup> For this purpose, a person is treated as related to another person if such persons are treated as a single employer under subsection (a) or (b) of section 52 or subsection (m) or (o) of section 414, except that determinations under subsections (a) and (b) of section 52 are made without regard to section 1563(b).

## **Definition of specified agricultural or horticultural cooperative**

The proposal limits the definition of specified agricultural or horticultural cooperative to organizations to which part I of subchapter T applies that (1) manufacture, produce, grow, or extract in whole or significant part any agricultural or horticultural product, or (2) market any agricultural or horticultural product that their patrons have so manufactured, produced, grown, or extracted in whole or significant part.<sup>120</sup> The definition no longer includes a cooperative solely engaged in the provision of supplies, equipment, or services to farmers or other specified agricultural or horticultural cooperatives.

## **Special rules**

All members of an expanded affiliated group<sup>121</sup> are treated as a single corporation and the deduction is allocated among the members of the expanded affiliated group in proportion to each member's respective amount, if any, of qualified production activities income. In addition, for purposes of determining domestic production gross receipts, if all of the interests in the capital and profits of a partnership are owned by members of a single expanded affiliated group at all times during the taxable year of such partnership, the partnership and all members of such group are treated as a single taxpayer during such period.

In the case of a specified agricultural or horticultural cooperative that is a partner in a partnership, rules similar to the rules applicable to a partner in a partnership under section 199A(f)(1) apply.

For a tax-exempt cooperative subject to tax on its unrelated business taxable income by section 511, the proposal is applied by substituting unrelated business taxable income for taxable income where applicable.

The section 199A(g) deduction is determined by only taking into account items that are attributable to the actual conduct of a trade or business.

## **Allocation of the cooperative's deduction to patrons**

The proposal provides that an eligible patron that receives a qualified payment from a specified agricultural or horticultural cooperative is allowed as a deduction for the taxable year in which such payment is received an amount equal to the portion of the cooperative's deduction for qualified production activities income that is (i) allowed with respect to the portion of the qualified production activities income to which such payment is attributable, and (ii) identified

---

<sup>120</sup> Consistent with former section 199, it is intended that agricultural or horticultural products also include fertilizer, diesel fuel, and other supplies used in agricultural or horticultural production that are manufactured, produced, grown, or extracted by the cooperative. See Treas. Reg. sec. 1.199-6(f).

<sup>121</sup> For this purpose, an expanded affiliated group is an affiliated group as defined in section 1504(a) determined (i) by substituting "more than 50 percent" for "more than 80 percent" each place it appears, and (ii) without regard to paragraphs (2) and (4) of section 1504(b).

by the cooperative in a written notice mailed to the patron during the payment period described in section 1382(d).<sup>122</sup>

The patron's deduction of such amount may not exceed the patron's taxable income for the taxable year (determined without regard to such deduction but after taking into account the patron's other deductions under section 199A(a)). A qualified payment is any amount that (i) is described in paragraph (1) or (3) of section 1385(a) (*i.e.*, patronage dividends and per-unit retain allocations), (ii) is received by an eligible patron from a specified agricultural or horticultural cooperative, and (iii) is attributable to qualified production activities income with respect to which a deduction is allowed to such cooperative. An eligible patron is (i) a taxpayer other than a corporation,<sup>123</sup> or (ii) another specified agricultural or horticultural cooperative.

Finally, the cooperative cannot reduce its income under section 1382 for any deduction allowable to its patrons under this rule (*i.e.*, the cooperative must reduce its deductions allowed for certain payments to its patrons in an amount equal to the section 199A(g) deduction allocated to its patrons).

### **Regulatory authority**

Specific regulatory authority is provided for the Secretary of the Treasury to promulgate necessary regulations under section 199A(g), including regulations that prevent more than one cooperative taxpayer from being allowed a deduction with respect to the same activity (*i.e.*, the same lease, rental, license, sale, exchange, or other disposition of any agricultural or horticultural product that was manufactured, produced, grown, or extracted in whole or in significant part within the United States). In addition, regulatory authority is provided to address the proper allocation of items of income, deduction, expense, and loss for purposes of determining qualified production activities income. The proposal provides that the regulations be based on the regulations applicable to cooperatives and their patrons under former section 199 (as in effect before its repeal).<sup>124</sup>

## **2. Treatment of cooperative patrons**

### **Repeal of special deduction for qualified cooperative dividends**

The proposal repeals the special deduction for qualified cooperative dividends. In addition, the proposal repeals the rule that excludes qualified cooperative dividends from qualified business income of a qualified trade or business. The proposal also clarifies that items

---

<sup>122</sup> Consistent with the allocation of the cooperative's deduction to its patrons under former section 199 and consistent with the requirements for the payment of patronage dividends in section 1388(a)(1), the cooperative's section 199A(g) deduction is allocated among its patrons on the basis of the quantity or value of business done with or for such patron by the cooperative.

<sup>123</sup> For this purpose, corporation does not include an S corporation.

<sup>124</sup> See Treas. Reg. secs. 1.199-1 through -9.

of income excluded from qualified items of income, and thus excluded from qualified business income, do not include any amount described in section 1385(a)(1) (*i.e.*, patronage dividends). Accordingly, qualified business income of a qualified trade or business includes any patronage dividend,<sup>125</sup> per-unit retain allocation,<sup>126</sup> qualified written notice of allocation,<sup>127</sup> or any other similar amount received from a cooperative, provided such amount is otherwise a qualified item of income, gain, deduction, or loss (*i.e.*, such amount is (i) effectively connected with the conduct of a trade or business within the United States, and (ii) included or allowed in determining taxable income for the taxable year).<sup>128</sup>

### **Reduced deduction for qualified payments received from a specified agricultural or horticultural cooperative**

In the case of any qualified trade or business of a patron of a specified agricultural or horticultural cooperative, the deductible amount determined under section 199A(b)(2) for such trade or business is reduced by the lesser of (1) nine percent of the amount of qualified business income with respect to such trade or business as is properly allocable to qualified payments received from such specified agricultural or horticultural cooperative, or (2) 50 percent of the amount of W-2 wages with respect to such qualified trade or business that are properly allocable to such amount.

### **3. Transition rule relating to the repeal of section 199**

The proposal clarifies that the repeal of section 199 for taxable years beginning after December 31, 2017, does not apply to a qualified payment received by a patron from a specified agricultural or horticultural cooperative in a taxable year beginning after December 31, 2017, to the extent such qualified payment is attributable to qualified production activities income with respect to which a deduction is allowable to the cooperative under former section 199 for a taxable year of the cooperative beginning before January 1, 2018. Such qualified payment remains subject to former section 199 and any section 199 deduction allocated by the cooperative to its patrons related to such qualified payment may be deducted by such patrons in accordance with former section 199. In addition, no deduction is allowed under section 199A for such qualified payments.

---

<sup>125</sup> Defined in sec. 1388(a).

<sup>126</sup> Defined in sec. 1388(f).

<sup>127</sup> Defined in sec. 1388(c).

<sup>128</sup> See sec. 199A(c)(3)(A).

#### 4. Examples

The following examples illustrate the proposal.

##### Example 1

Cooperative is a grain marketing cooperative with \$5,250,000 in gross receipts during 2018 from the sale of grain grown by its patrons. Cooperative paid \$4,000,000 to its patrons at the time the grain was delivered in the form of per-unit retain allocations and another \$1,000,000 in patronage dividends after the close of the 2018 taxable year. Cooperative has other expenses of \$250,000 during 2018, including \$100,000 of W-2 wages.

Cooperative has domestic production gross receipts of \$5,250,000 and qualified production activities income of \$5,000,000<sup>129</sup> for 2018. Cooperative's section 199A(g) deduction is \$50,000 and is equal to the least of nine percent of qualified production activities income (\$450,000),<sup>130</sup> nine percent of taxable income (\$450,000),<sup>131</sup> or 50 percent of W-2 wages (\$50,000).<sup>132</sup> Cooperative passes through the entire section 199A(g) deduction to its patrons. Accordingly, Cooperative reduces its \$5,000,000 deduction allowable under section 1382(b) and (c) (relating to the \$1,000,000 patronage dividends and \$4,000,000 per-unit retain allocations) by \$50,000.

Patron's grain delivered to Cooperative during 2018 is two percent of all grain marketed through Cooperative during such year. During 2019, Patron receives \$20,000 in patronage dividends and \$1,000 of allocated section 199A(g) deduction from Cooperative related to the grain delivered to Cooperative during 2018.

Patron is a grain farmer with taxable income of \$75,000 for 2019 (determined without regard to section 199A) and has a filing status of married filing jointly. Patron's qualified business income related to its grain trade or business for 2019 is \$50,000, which consists of gross receipts of \$150,000 from sales to an independent grain elevator, per-unit retain allocations received from Cooperative during 2019 of \$80,000, patronage dividends received from Cooperative during 2019 related to Cooperative's 2018 net earnings of \$20,000, and expenses of \$200,000 (including \$50,000 of W-2 wages).

The portion of the qualified business income from Patron's grain trade or business related to qualified payments received from Cooperative during 2019 is \$10,000, which consists of per-unit retain allocations received from Cooperative during 2019 of \$80,000, patronage dividends

---

<sup>129</sup> \$5,250,000 gross receipts - \$250,000 expenses = \$5,000,000.

<sup>130</sup> \$5,000,000 \* .09 = \$450,000.

<sup>131</sup> For this purpose, taxable income is \$5,000,000 and is determined without regarding to the section 199A(g) deduction and without regard to the \$5,000,000 deduction allowable under section 1382(b) and (c) relating to the \$1,000,000 patronage dividends and \$4,000,000 per-unit retain allocations.

<sup>132</sup> \$100,000 \* .5 = \$50,000.

received from Cooperative during 2019 related to Cooperative's 2018 net earnings of \$20,000, and properly allocable expenses of \$90,000 (including \$25,000 of W-2 wages).<sup>133</sup>

Patron's deductible amount related to the grain trade or business is 20 percent of qualified business income (\$10,000)<sup>134</sup> reduced by the lesser of nine percent of qualified business income related to qualified payments received from Cooperative (\$900)<sup>135</sup> or 50 percent of W-2 wages related to qualified payments received from Cooperative (\$12,500),<sup>136</sup> or \$9,100. As Patron does not have any other qualified trades or business, the combined qualified business income amount is also \$9,100.

Patron's deduction under section 199A for 2019 is \$10,100, which consists of the combined qualified business income amount of \$9,100, plus Patron's deduction passed through from Cooperative of \$1,000.

### **Example 2**

Cooperative and Patron have the same facts as above for 2018 and 2019 except that Patron has expenses of \$200,000 that include zero W-2 wages during 2019.

Patron's deductible amount related to the grain trade or business is 20 percent of qualified business income (\$10,000) reduced by the lesser of nine percent of qualified business income related to qualified payments received from Cooperative (\$900), or 50 percent of W-2 wages related to qualified payments received from Cooperative (\$0), or \$10,000.

Patron's deduction under section 199A for 2019 is \$11,000, which consists of the combined qualified business income amount of \$10,000, plus Patron's deduction passed through from Cooperative of \$1,000.

### **Effective Date**

The proposal is effective as if included in the amendments made by sections 11011 and 13305 of Public Law No. 115-97, that is, for taxable years beginning after December 31, 2017.

---

<sup>133</sup> Which expenses are properly allocable in a given case will depend on all the facts and circumstances. The example assumes that the fraction of properly allocable W-2 wages differs from the fraction of other properly allocable expenses.

<sup>134</sup>  $\$50,000 * .2 = \$10,000.$

<sup>135</sup>  $\$10,000 * .09 = \$900.$

<sup>136</sup>  $\$25,000 * .5 = \$12,500.$

**C. Low-Income Housing Credit Ceiling and Average Income Test  
(secs. 102 and 103 of Division T of the amendment and sec. 42 of the Code)**

**Present Law**

The low-income housing credit may be claimed over a 10-year credit period after each low-income building is placed in service. The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building. A State housing credit ceiling applies. For determining the current-year State dollar amount of the ceiling in any calendar year, the greater of (i) \$1.75 multiplied by the State population, or (ii) \$2,000,000, is taken into account. These amounts are indexed for inflation. For calendar year 2018, the amounts are \$2.40 and \$2,760,000.

To be eligible for the low-income housing credit, a qualified low-income building must be part of a qualified low-income housing project. In general, a qualified low-income housing project is defined as a project that satisfies one of two tests at the election of the taxpayer. The first test is met if 20 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income (the “20-50 test”). The second test is met if 40 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income (the “40-60 test”).

A unit occupied by individuals whose incomes rise above 140 percent of the applicable income limit shall continue to be treated as a low-income unit if the income of such occupants initially met such income limitation and such unit continues to be rent-restricted so long as the next available unit is occupied by a tenant whose income does not exceed such limitation. In the case of deep rent skewed projects, special rules apply. A deep rent skewed project is a project in which (i) 15 percent or more of the low-income units in the project are occupied by individuals whose incomes are 40 percent or less of area median gross income, (ii) the gross rent with respect to each low-income unit in the project does not exceed 30 percent of the applicable income limit that applies to individuals occupying the unit, and (iii) the gross rent with respect to each low-income unit in the project does not exceed ½ of the average gross rent with respect to units of comparable size that are not occupied by individuals who meet the applicable income limit.

**Explanation of Provision**

**State housing credit ceiling**

The provision provides an increase in the State housing credit ceiling for 2018, 2019, 2020, and 2021. In each of those calendar years, the dollar amounts in effect for determining the current-year ceiling (after any increase due to the applicable cost of living adjustment) are increased by multiplying the dollar amounts for that year by 1.125.

### **Average income test for qualified low-income housing project**

The provision adds a third optional test to the 20-50 and 40-60 tests for a qualified low-income housing project. A project meets the minimum requirements of the average income test if 40 percent or more (25 percent or more in the case of a project located in a high cost housing area) of the residential units in such project are both rent-restricted and occupied by individuals whose income does not exceed the imputed income limitation designated by the taxpayer with respect to the respective unit.

The taxpayer designates the imputed income limitation. The imputed income limitation is determined in 10-percentage-point increments, and may be designated as 20, 30, 40, 50, 60, 70, or 80 percent. The average of the imputed income limitations designated must not exceed 60 percent of area median gross income.

For purposes of the rental of the next available unit in a project with respect to which the taxpayer elects the average income test, if the income of the occupants of the unit increases above 140 percent of the greater of (i) 60 percent of area median gross income, or (ii) the imputed income limitation designated by the taxpayer with respect to the unit, then the unit ceases to be treated as a low-income unit if any residential rental unit in the building (of a size comparable to, or smaller than, such unit) is occupied by a new resident whose income exceeds the applicable imputed income limitation. In the case of a deep rent skewed project, 170 percent applies instead of 140 percent, and other special rules apply.

### **Effective Date**

The provision relating to the State housing credit ceiling is effective for calendar years beginning after December 31, 2017, and before January 1, 2022.

The provision relating to the average income test is effective for elections made after the date of enactment.

## II. TAX TECHNICAL CORRECTIONS ACT OF 2018 (DIVISION U OF THE AMENDMENT)

Division U of the amendment includes technical corrections, other corrections, and clerical and deadwood corrections to recent tax legislation enacted before 2017. Except as otherwise provided, the amendments made by the technical corrections and other corrections contained in Division U of the amendment take effect as if included in the original legislation to which each amendment relates.

### A. Title I – Tax Technical Corrections

#### **Amendments relating to the Protecting Americans from Tax Hikes (“PATH”) Act of 2015 (Division Q of the Consolidated Appropriations Act, 2016)**

**Earned income tax credit permanent rules (Act sec. 103).**—The Act made permanent the \$5,000 increase in the phaseout amount for married couples filing joint returns. The Act retained rules providing for the indexation of the prior-law \$3,000 amount (notwithstanding that this amount had been repealed). The provision deletes references to the prior law amount and consolidates the inflation adjustment in one subsection.

**Transit parity (Act sec. 105).**—Under Code section 132(f)(2) as in effect before the changes made by the Act, the monthly limit on the fringe benefit exclusion for employer-provided parking was \$175, and the monthly limit on employer-provided benefits for mass transit and van pooling combined was \$100. These monthly limits were indexed under Code section 132(f)(6) using a base year determined by when the particular monthly limit became effective – a base year of 1998 for parking and 2001 for transit/vanpooling. Parity between the exclusions was provided on a temporary basis from 2009 through 2014. The Act created permanent parity in the exclusions by changing the monthly transit/vanpooling limit in Code section 132(f)(2) to \$175. However, the Act failed to include a conforming change to repeal the base-year rule in Code section 132(f)(6) for transit/vanpooling. The provision repeals the transit/vanpooling base-year rule.

**Research credit: not reinstate alternative incremental credit (Act sec. 121).**—The alternative incremental credit expired in 2008. The provision clarifies that the alternative incremental credit is not reinstated by the Act, and makes conforming changes.

**Bonus depreciation (Act sec. 143).**—The provision clarifies that, among the criteria in the Act defining certain property having a longer production period that is treated as qualified property, the requirement that the property be acquired pursuant to a written contract before 2020 requires that the contract be a written binding contract. This corrects an unintended error that changed prior law.

The provision clarifies that the preproductive period under Code section 168(k)(5)(B)(ii) is consistent with the preproductive period under Code section 263A(e)(3).

The provision amends Code section 168(k)(6), as in effect prior to the amendments made by section 13201 of the 2017 Act,<sup>137</sup> to provide the intended applicable percentages. Thus, the provision clarifies that in the case of longer production period property and certain aircraft acquired before September 28, 2017, and placed in service in 2018, 50 percent applies to the entire adjusted basis, and if placed in service in 2019, 40 percent applies to the entire adjusted basis.

The provision clarifies that if, for a taxable year, a taxpayer makes both an election under Code section 168(k)(7) not to claim bonus depreciation for all property in a particular class of property and an election under Code section 168(k)(4) to claim AMT credits in lieu of bonus depreciation, Code section 168(k)(4) does not apply to property in the particular class. This corrects an unintended error which changed prior law.

**Election out of accelerated recovery periods for qualified Indian reservation property (Act sec. 167).**—As amended by the Act, Code section 168(j) permits taxpayers to elect out of the otherwise applicable accelerated recovery periods in the case of qualified Indian reservation property. In general, if section 168(j) applies, there is no AMT adjustment (see section 168(j)(3)). The provision clarifies that no AMT adjustment applies in the case of qualified Indian reservation property if the taxpayer makes the election out.

**Failure to furnish correct payee statements (Act sec. 202).**—The provision clarifies Code section 6722(c)(3)(A), relating to failure to furnish correct payee statements, to refer to the payee statement (rather than to information returns) that are furnished (rather than filed). A corresponding change in the effective date stated in the Act refers to statements that are furnished (rather than provided). Similarly-structured language in Code section 6721(c)(3)(A) is conformed so that it refers to the information return (rather than to any information return).

**Requirements for the issuance of Individual Taxpayer Identification Numbers (“ITINs”) (Act sec. 203).**—The provision clarifies that community-based Certifying Acceptance Agents are among the entities that are available to individuals living abroad who wish to obtain ITINs for purposes of meeting their U.S. tax filing obligations.

The provision clarifies that the expiration of ITINs that have not been used for three consecutive taxable years is to occur on the date following the due date of the tax return for such third consecutive taxable year. For ITINs issued prior to January 1, 2013, the ITIN will expire on the applicable date, or if earlier, the day following the due date of the tax return for the third consecutive taxable year such ITIN was not used on a return. In the event that such an ITIN has not been used for three (or more) consecutive taxable years on the tax return due date for the 2015 taxable year, such ITIN shall expire on the day following that date.

The provision clarifies that the effective date of section 203 of the Act, which provides that Act section 203 is effective for ITIN applications made after the date of enactment, does not prevent the provision relating to outstanding ITINs from taking effect.

---

<sup>137</sup> Pub. L. No. 115-97.

**Retroactive claims of credits (Act secs. 204, 205, and 206).**—The provision conforms a reference in Code section 24(e)(2) to the taxpayer identification number (not to the identifying number). The provisions remove special effective date rules in each of these Act sections that have no practical effect.

**Effective date for treatment of credits for certain penalties (Act sec. 209).**—The Act inadvertently failed to state the effective date for the rule providing a reasonable cause exception for erroneous claims for refund or credit. The provision states that the effective date is for claims filed after the date of enactment of the Act.

**Making American Opportunity Tax Credit permanent (Act secs. 102, 206, 207, 208, and 211).**—The provision reflects the permanent extension of the American Opportunity Tax Credit by eliminating deadwood and consolidating the provisions of Code section 25A.

**Section 529 programs and qualified ABLE programs (Act secs. 302(b)).**—For section 529 qualified tuition programs, the Act repealed the rules providing that section 529 accounts must be aggregated for purposes of calculating the amount of a distribution that is included in a taxpayer’s income. Though Act section 303 modified certain rules for qualified ABLE programs, it did not make a parallel change to the rules for distributions from ABLE accounts. The provision makes a parallel change that conforms the treatment of multiple distributions during a taxable year from an ABLE account in Code section 529A to the treatment of multiple distributions during a taxable year from a section 529 account.

**Restriction on tax-free distributions involving Real Estate Investment Trusts (“REITs”) (Act sec. 311).**—The provision clarifies that, for purposes of Code section 355(h)(2)(B), control of a partnership means ownership of at least 80 percent of the profits interests and at least 80 percent of the capital interests. That is, control is not limited to exactly 80 percent ownership.

**Ancillary personal property of a REIT (Act sec. 318).**—As amended by the Act, Code section 856(c)(9) treats ancillary personal property as a real estate asset for purposes of the REIT 75 percent asset test to the extent that rents attributable to such ancillary personal property are treated, under a separate provision, as rents from real property. The provision makes two conforming changes with respect to the REIT income tests. First, the provision treats gain from the sale or disposition of such ancillary personal property as gain from the sale or disposition of a real estate asset for purposes of the REIT income tests. Second, the provision treats gain from the sale or disposition of certain obligations secured by mortgages on both real property and personal property as gain from the sale or disposition of real property for purposes of the REIT income tests.

**Exception from Foreign Investment in U.S. Real Property Tax Act (“FIRPTA”) for certain stock of REITs (Act sec. 322).**—The provision restates provisions of Code section 897(k) as amended, makes clerical conforming changes, and strikes a modification to a repealed provision.

Further, under Code section 897(k) as amended, the provision addresses the definition of a qualified collective investment vehicle that is eligible for benefits of a comprehensive income

tax treaty with the United States that includes an exchange of information program. Specifically, the provision clarifies that the definition can be met only if the dividends article in the treaty imposes conditions on the benefits allowable in the case of dividends paid by a REIT.

The provision clarifies the effective date for the determination of domestic control by stating that the rule applies with respect to each testing period ending on or after the date of enactment (not that the rule takes effect on the date of enactment).

**FIRPTA exception for qualified foreign pension funds (Act sec. 323).**—As amended by the Act, Code section 897(l)(1) provides that Code section 897 does not apply (i) to any United States real property interest held directly (or indirectly through one or more partnerships) by, or (ii) to any distribution received from a REIT by, a qualified foreign pension fund or an entity all the interests of which are held by a qualified foreign pension fund. The provision clarifies that, for purposes of Code section 897, a qualified foreign pension fund is not treated as a nonresident alien individual or as a foreign corporation; in other words, in determining the U.S. income tax of a qualified foreign pension fund, Code section 897 does not apply. The provision provides that, also for that purpose, an entity all the interests of which are held by a qualified foreign pension fund is treated as such a fund.

As amended by the Act, Code section 897(l)(2) establishes a five-prong definition of the term “qualified foreign pension fund.” The provision revises the second prong of the definition to clarify that a government-established fund to provide public retirement or pension benefits may qualify, as well as a fund established by more than one employer to provide retirement or pension benefits to their employees, such as a multiple-employer or multiemployer plan. In addition, the provision makes clarifying changes to the fourth and fifth prongs of the definition.

**Election of certain small insurance companies to be taxed only on taxable investment income (Act sec. 333).**—As amended by the Act, Code section 831(b) requires that an otherwise eligible electing insurance company meet one of two diversification requirements. The first requires that no more than 20 percent of the company’s net (or if greater, direct) written premiums for the taxable year is attributable to any one policyholder. The second, applicable if the first is not met, requires that no person holds (directly or indirectly) aggregate interests in the company that constitute a percentage of the entire interest in the company that is more than a de minimis percentage higher than the percentage of interests in specified assets with respect to the company held (directly or indirectly) by a specified holder.

The provision clarifies the first diversification rule to provide a look-through rule with respect to an intermediary (for example, an aggregate fund). Specifically, the provision provides that in the case of reinsurance or any fronting, intermediary, or similar arrangement, a policyholder means each policyholder of the underlying direct written insurance with respect to the reinsurance or arrangement.

The provision clarifies the determination of percentages under the second diversification rule by making the determination with respect to relevant specified assets. They are defined (with respect to any specified holder with respect to any insurance company) to mean the aggregate amount of the specified assets, with respect to the insurance company, any interest in which is held directly or indirectly by a spouse or specified relation. A specified relation is a

lineal descendent (including by adoption) of an individual who holds, directly or indirectly, an interest in the insurance company, and the lineal descendant's spouse. Thus, for example, a specified relation of an individual includes the individual's step-children. The provision further clarifies that relevant specified assets do not include any specified asset that was acquired by the spouse or specified relation by bequest, devise, or inheritance from a decedent for a two-year period.

A specified holder is defined to include a lineal descendent (including by adoption) of an individual who holds, directly or indirectly, an interest in the insurance company, and the lineal descendant's spouse. Thus, a specified holder includes an individual's step-children. A specified holder is defined also to include a non-U.S.-citizen spouse of an individual who holds, directly or indirectly, an interest in the specified assets with respect to the insurance company. A non-U.S.-citizen spouse would generally not be an eligible recipient for purposes of the unified estate and gift tax marital deduction, for example, and so assets passing to such a spouse from such an individual would not be deductible for estate and gift tax purposes. By contrast, a U.S.-citizen spouse could receive assets from the individual without giving rise to estate tax or gift tax with respect to those assets.

Treasury Department guidance under the provision may provide that factors such as ownership, premiums, gross revenue, and factors taken into account under applicable State law for assessing risk are taken into account, to the extent this is consistent with the purpose of the provision to accurately determine percentages based on the real economic arrangement among the parties.

#### **Amendment relating to Division P of the Consolidated Appropriations Act, 2016**

**Treatment of transportation costs of independent refiners (Act sec. 305).**—The provision clarifies that Code section 199(c)(3)(C) applies for purposes of calculating qualified production activities income under Code section 199(c) and for purposes of calculating oil related qualified production activities income under Code section 199(d)(9), as in effect before the repeal of Code section 199 as part of the 2017 Act.

The provision clarifies that an independent refiner may elect to apply section 199(c)(3)(C) to its oil transportation costs for purposes of calculating its deduction under Code section 199 (i.e., it is not required to apply the provision to its oil transportation costs). It is anticipated that the Secretary will issue guidance prescribing the manner in which such election shall be made.

#### **Amendments relating to the Fixing America's Surface Transportation Act (2015)**

**Revocation or denial of passport in case of certain unpaid taxes (Act sec. 32101).**—The Act provides for judicial review of the Secretary's certification that an individual has a seriously delinquent tax debt, either in a U.S. district court or in the Tax Court. The provision clarifies that the party against whom a Tax Court petition is filed is the Commissioner of the Internal Revenue Service. The provision also provides a tie-breaker rule clarifying that the court first acquiring jurisdiction over the action has sole jurisdiction, and corrects a cross reference.

## **Amendments relating to the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015**

**Consistent value for transfer and income tax purposes (Act sec. 2004).**—The Act generally requires that an heir who acquires property from a decedent (whether or not reported on an estate tax return) claim a basis no greater than the final value of the property for estate tax purposes (new Code section 1014(f)). New Code section 6662(b)(8) imposes a penalty in the case of an inconsistent estate basis. Under the provision, the term “inconsistent estate basis” means any portion of an underpayment attributable to the failure to comply with section 1014(f). The penalty could have been viewed as applying when an heir claims a basis higher than the final estate tax value by reason of making basis adjustments relating to post-acquisition events (e.g., improvements to the property). This result is not intended. The provision modifies the definition of inconsistent estate basis to avoid this unintended result.

**Mass Transit Account (“MTA”) financing (Act sec. 2008).**—The Act changes the taxation of liquefied natural gas (LNG) and liquefied petroleum gas (LPG) from a per-gallon basis to an energy-equivalent basis. That is, the Act provides that the tax is based on the LNG energy equivalent to a gallon of diesel (DGE) (24.3 cents per DGE, which is 6.06 pounds of LNG), and on the LPG energy equivalent to a gallon of gasoline (GGE) (18.3 cents per GGE, which is 5.75 pounds of LPG). Code section 9503(e)(2) allocates 1.86 cents per gallon of LNG and 2.13 cents per gallon of LPG to the MTA of the Highway Trust Fund, but the Act does not specifically conform the per-gallon basis to an energy-equivalent basis for purposes of the allocation. The provision conforms the per-gallon basis in Code section 9503(e)(2) to the energy-equivalent basis, using DGE for LNG and GGE for LPG, to reflect the energy-equivalent basis used for the taxes imposed on LNG and LPG.

## **Amendments relating to the Stephen Beck, Jr., ABLE Act of 2014**

**Inflation adjustment for certain civil penalties under the Internal Revenue Code of 1986 (Act sec. 208).**—The Act provides an annual inflation adjustment for fixed-dollar civil tax penalties in the case of: (i) Code section 6651(a), failure to file a tax return; (ii) Code section 6652(c), failure to file or disclose information returns by exempt organizations and certain trusts, (iii) Code section 6695, preparation of tax returns for other persons, (iv) Code section 6698, failure to file a partnership return, (v) Code section 6699, failure to file an S corporation return, (vi) Code section 6721, failure to file correct information returns, and (vii) Code section 6722, failure to furnish correct payee statements. The provision clarifies that the effective date of the annual inflation adjustments added to these civil penalties generally is for returns required to be filed, and statements required to be furnished, after December 31, 2014, and in the case of the annual inflation adjustment for penalties relating to preparation of tax returns for other persons, is for returns or claims for refund filed after December 31, 2014.

## **Amendment relating to the American Taxpayer Relief Act of 2012**

**Reference in definition of a deficiency to American Opportunity Tax Credit (Act sec. 104).**—The provision conforms a reference in Code section 6211(b)(4)(A), relating to the definition of a deficiency, to a provision of the American Opportunity Tax Credit that was renumbered by the Act.

## **Amendment relating to the United States–Korea Free Trade Agreement Implementation Act (2011)**

**Increase in penalty on paid preparers who fail to comply with earned income tax credit due diligence requirements (Act sec. 501).**—The provision clarifies that the effective date of the Code section 6695(g) penalty increase is for documents prepared (not returns required to be filed) after December 31, 2011.

## **Amendment relating to SAFETEA-LU**

**Penalty relating to signs (Act sec. 1125).**—Persons engaged in distilled spirits operations are required to place and keep conspicuously on the outside of such place of business a sign showing the name of such person and denoting the business, or businesses, in which engaged. Code section 5681 imposes penalties for failure to post a required sign and posting or displaying a false sign. Under Code section 5681(b), a wholesale dealer in liquors may display a distilled spirits operations sign only if that person has paid the special occupational tax applicable to those wholesalers, payment of the tax being the indication that such person was eligible to post such a sign. SAFETEA-LU repealed the special occupational taxes, but did not make a conforming change to the penalty provision under 5681(b). The provision corrects the outdated reference in the penalty for displaying a false sign. Specifically, the provision modifies Code section 5681(b) to provide that a wholesale dealer in liquors may post a sign indicating that it is engaged in distilled spirits operations only if that person has complied with the recordkeeping requirements required by Code section 5121(a) and the registration requirements under Code section 5124.

## **Amendments relating to the American Jobs Creation Act of 2004**

**Treatment of certain trusts as shareholder of S corporation (Act sec. 233).**—The provision clarifies that only the individual for whose benefit the trust is created is treated as “the shareholder.”

**Rural electric cooperatives (Act sec. 319).**—Code section 501(c)(12) of the Code provides an income tax exemption for rural electric cooperatives if at least 85 percent of the cooperative’s income consists of amounts collected from members for the sole purpose of meeting losses and expenses of providing service to its members. The Energy Policy Act of 2005 made permanent a rule to exclude from the 85 percent test income from transactions related to open access transmission if approved by the Federal Energy Regulatory Commission (“FERC”). FERC regulates transmission lines in all States except Alaska, Hawaii, and most of Texas. Because of an oversight, only transmission systems in Texas received the treatment accorded to FERC-regulated electric cooperatives. Electric cooperatives in Alaska are regulated by the Regulatory Commission of Alaska (“RCA”). Regulated utilities in Alaska with an RCA-approved open access transmission tariff modeled after FERC should have received the same tax treatment as their similarly situated counterparts in the other States. The provision clarifies that that such utilities in Alaska and Hawaii are treated the same as those in Texas for purposes of the exclusion from the 85-percent test.

**B. Title II – Technical Corrections Related to Partnership Audit Rules  
(sec. 1101 of the Bipartisan Budget Act of 2015 and secs. 6221-6241 of the Code)**

The provisions correct and clarify provisions relating to the partnership audit rules enacted in the Bipartisan Budget Act of 2015, as amended by the PATH Act of 2015, to express the intended rule. Section and chapter references are to the Internal Revenue Code of 1986 unless otherwise indicated.

**Scope of adjustments subject to partnership audit rules (sec. 201 of Division U of the amendment and secs. 6241(2) and (9), 6501(c), 6221, 6225, 6226, 6227, 6231, 6234, and 7485 of the Code)**

The provision clarifies the scope of the partnership audit rules. The provision eliminates references to adjustments to partnership income, gain, loss, deduction, or credit, and instead refers to partnership-related items, defined as any item or amount with respect to the partnership that is relevant in determining the income tax liability of any person, without regard to whether the item or amount appears on the partnership’s return and including an imputed underpayment and an item or amount relating to any transaction with, basis in, or liability of, the partnership. Thus, these partnership audit rules are not narrower than the Tax Equity and Fiscal Responsibility Act of 1982 (“TEFRA”) partnership audit rules, but rather, are intended to have a scope sufficient to address those items described as partnership items, affected items, and computational items in the TEFRA context in Treasury Regulations sections 301.6231(a)(3), 301.6231(a)(5), and 301.6231(a)(6), as well as any other items meeting the statutory definition of a partnership-related item.

For example, because a partnership-related item includes an item or amount relating to any transaction with the partnership, an item or amount relating to a partner’s transaction with a partnership other than in his capacity as a member of the partnership (which is considered as occurring between the partnership and one who is not a partner under section 707) is a partnership-related item. As another example, because a partnership-related item includes an item or amount relating to basis in the partnership, an item or amount relating to the determination of the adjusted basis of a partner’s interest in the partnership or relating to the basis of the partnership in partnership property is a partnership-related item. As a further example, because a partnership-related item includes an item or amount relating to liability of the partnership, an item or amount relating to the determination of partnership liabilities or to the effect on a partner of a decrease or increase in a partner’s share of partnership liabilities is a partnership-related item.

The provision clarifies that the partnership audit rules do not apply to taxes imposed, or to amounts required to be deducted or withheld, under Code chapters 2 (tax on self-employment income) or 2A (tax on net investment income), 3 (withholding tax on nonresident alien individuals or foreign corporations), or 4 (withholding tax for certain foreign accounts), except as otherwise specifically provided. However, any partnership adjustment determined under the income tax is taken into account for purposes of determining and assessing tax under these chapters of the Code to the extent that the partnership adjustment is relevant to the determination. Further, a timing rule applies in the case of chapters 3 and 4.

For example, if a partnership adjustment results in a change in the amount of income of an individual from a partnership, the change is reflected as required under the rules of chapter 2 in the calculation of the individual's net earnings from self-employment with respect to the partnership, and the chapter 2 tax may be collected through a process that is outside the partnership audit rules.

The period for assessing any tax under chapter 2 or 2A that is attributable to a partnership adjustment does not expire before the date that is one year after (1) in the case of an adjustment pursuant to the decision of a court in a proceeding brought under Code section 6234, such decision becomes final, or (2) in any other case, 90 days after the date on which the notice of final partnership adjustment is mailed under Code section 6231.

The provision applies a specific timing rule in the case of any tax imposed, including any amount that is required to be deducted or withheld, under chapter 3 (withholding tax on nonresident alien individuals or foreign corporations) or 4 (withholding tax for certain foreign accounts). In these cases, the tax is determined with respect to the reviewed year. The tax is imposed with respect to the adjustment year; similarly, the amount required to be deducted or withheld is deducted or withheld with respect to the adjustment year. The reviewed year and the adjustment year are defined in section 6225(d). For example, assume that a partnership has foreign partners, and that following an audit of the partnership, an adjustment is made to the amount of the partnership's effectively connected taxable income. The adjustment results in an increase of \$100x of such income that is allocable to foreign partners with respect to the reviewed year. Pursuant to section 1446, assume that the amount of withholding tax that the partnership is required to pay with respect to this income allocable to the foreign partners is \$35x. The \$35x is required to be paid by the partnership with respect to the adjustment year (as defined in section 6225(d)(2)). As a further example, assume that a partnership, P, with foreign partners is not the audited partnership, but rather, is an upper tier partner of an audited partnership that has elected to push out under section 6226. Partnership P has received a statement pursuant to section 6226, described below. The amount of withholding tax partnership P is required to pay is determined with respect to the reviewed year of the audited partnership, as it affects the relevant taxable year of partnership P. The amount of withholding tax is required to be paid by partnership P for the partnership taxable year that is the adjustment year, in this case, the adjustment year of the audited partnership (sec. 6225(d)). The due date for partnership P's payment of the withholding tax is no later than the due date (including allowable extensions) for the return for the adjustment year of the audited partnership.

In determining the amount of any deficiency, adjustments to partnership-related items are made only as provided under the partnership audit rules (Subchapter C of Chapter 63 of the Code), except to the extent otherwise provided. Conforming references to partnership-related items are made in several other provisions, including the provision relating to the scope of judicial review of a partnership adjustment (sec. 6234(c)).

Thus, it is clarified that the court has jurisdiction to determine all partnership-related items of the partnership for the partnership taxable year to which the notice of final partnership adjustment relates, the proper allocation of such items among the partners, and the applicability of any penalty, addition to tax, or additional amount for which the partnership may be liable under subchapter C of chapter 63 of the Code. For example, because partnership-related items

include items or amounts with respect to (a) section 707 transactions, (b) liabilities of the partnership and the partners' shares of the liabilities, and (c) the basis of a partnership interest or of partnership property, determination of these items or amounts is within the scope of judicial review.

**Netting in the determination of imputed underpayments (sec. 202 of Division U of the amendment and sec. 6225 (a) and (b) of the Code)**

When the Secretary makes adjustments to any partnership-related item with respect to the reviewed year of a partnership, if the adjustments result in an imputed underpayment, the partnership pays an amount equal to the imputed underpayment, and if the adjustments do not result in an imputed underpayment, the adjustments are taken into account by the partnership in the adjustment year and passed through to the adjustment year partners. The provision clarifies this rule by conforming the language referring to partnership-related items and by striking erroneous references to separately stated income or loss.

The provision clarifies the manner of netting items to determine the amount of an imputed underpayment of a partnership. The provision clarifies that items of different character (capital or ordinary), for example, are not netted together in determining the amount of an imputed underpayment. Rather, an imputed underpayment of a partnership with respect to a reviewed year is determined by the Secretary by appropriately netting partnership adjustments for that year and by applying the highest rate of tax in effect for the reviewed year under section 1 or 11.

In the case of partners' distributive shares, like items within categories under section 702(a)(1)-(8) are separately netted. For example, netting within categories of items that are netted for purposes of reporting to partners on Schedule K-1 pursuant to section 702 may be considered as appropriately netting.

In determining an imputed underpayment, any adjustment that reallocates the distributive share of any item from one partner to another is taken into account by disregarding any part of the adjustment that results in a decrease in the amount of the imputed underpayment. For example, this rule could be implemented by disregarding the decrease in any item of income or gain and disregarding the increase in any item of deduction, loss, or credit.

Limitations that would apply at the direct or indirect partner level are treated as applying, unless otherwise determined. Under the provision, if an adjustment would decrease the imputed underpayment, and could be subject to a limitation or not be allowed against ordinary income if the adjustment were taken into account by any person, then the adjustment is not taken into account in determining the imputed underpayment of the partnership, except to the extent the Secretary otherwise provides.

For example, if an adjustment would increase the amount of a partnership loss allocable to partners, but the loss could be subject to the passive loss rule of section 469 in the hands of direct and indirect partners of the partnership, then the Secretary does not take into account the adjustment increasing the loss in determining the amount of the partnership's imputed underpayment, unless the Secretary provides otherwise. For example, the Secretary may provide

otherwise if the partnership supplies accurate information that all direct and indirect partners of the partnership are publicly traded domestic C corporations not subject to the passive loss rule.

Adjustments to credits are separately determined and netted as appropriate. Adjustments to credits are not multiplied by the tax rate, but rather, adjustments to items of credit are taken into account as an increase or decrease in determining the amount of the imputed underpayment.

It is intended that an imputed underpayment may be modified under procedures described in section 6225(c).

**Alternative procedure to filing amended returns for purposes of modifications to imputed underpayments (secs. 202(b), 202(c)(2), 203, and 206(b) of Division U of the amendment and secs. 6225(c) and 6201(a)(1) of the Code)**

The provision clarifies the modification rules of section 6225(c) to better carry out their function as intended by Congress, that is, to determine the amount of tax due as closely as possible to the tax due if the partnership and partners had correctly reported and paid while at the same time to implement the most efficient and prompt assessment and collection of tax attributable to the income of the partnership and partners.

The provision clarifies the procedures under section 6225(c)(2) that permit a partnership to seek modification of an imputed underpayment. These procedures allow reviewed-year partners to take adjustments into account so that the partnership's imputed underpayment can be determined by the Secretary without regard to that portion of the adjustments. Like other modification procedures in section 6225(c), these procedures take place within the period ending 270 days after the date the notice of proposed partnership adjustment is mailed, unless the period is extended with the consent of the Secretary, as provided in section 6225(c)(7).

**Amended returns of partners**

The provision clarifies the requirements for reviewed-year partners filing amended returns with payment of any tax due. First, the amended return procedure requires the partner to file returns for the taxable year of the partner that includes the end of the partnership's reviewed year, as well as for any taxable year with respect to which any tax attribute of the partner is affected by reason of any adjustment to a reviewed-year partnership-related item. Second, the amended returns are required to take into account all such adjustments that are properly allocable to the partner, as well as the effect of the adjustments on any tax attributes. Third, payment of any tax due is required to be included with the amended returns. As is the case for other amended returns, the Secretary may require the payment of interest, penalties, and additions to tax (for example, by billing the partner as under present practice).

If the requirements are satisfied, then the partnership's imputed underpayment amount is determined without regard to the portion of the adjustments taken into account by such partners. The amended return modification procedure does not require the participation of all reviewed year partners of the partnership. Direct and indirect reviewed-year partners may participate. The amended return procedure is not intended to cover adjustments to items on an amended return of

a partner that do not correspond to adjustments to a reviewed-year partnership-related item and the effect of the adjustments on tax attributes.

#### Alternative procedure to filing amended returns (pull-in)

The provision sets forth an alternative procedure to filing amended returns. The alternative procedure is referred to as the pull-in procedure. Under the pull-in procedure, the Secretary determines the partnership's imputed underpayment as reduced by the portion of the adjustments to partnership-related items that direct and indirect reviewed-year partners take into account and with respect to which those partners pay the tax due, provided the requirements of the pull-in procedure are met.

Under pull-in, reviewed-year partners pay the tax that would be due with amended returns, make binding changes to their tax attributes for subsequent years, and provide the Secretary with the information necessary to substantiate that the tax was correctly computed and paid. However, the partners file no amended returns. Thus, there are generally no corollary effects on the partners' returns beyond the effects on tax attributes, in other taxable years, of the adjustments to partnership-related items.

Pull-in, as well as the amended return modification procedure, is available generally to direct and indirect reviewed-year partners, in the case of tiered partnerships. The pull-in procedure generally does not require the participation of all direct and indirect reviewed-year partners of the partnership.

Pull-in requires the participating partner to pay the tax that would be due under the amended return filing procedure. The partner is responsible for remitting the payment unless the Secretary provides that another person, such as the partnership or a third party, may remit the payment on the partner's behalf. Payment is due within the period ending 270 days after the date the notice of proposed partnership adjustment is mailed (unless the period is extended with the Secretary's consent).

Pull-in requires that the partner agree to take into account, in the form and manner required by the Secretary, the adjustments and the effects on the partner's tax attributes of the adjustments to partnership-related items properly allocable to the partner.

Pull-in requires that the partner provide, in the form and manner specified by the Secretary, such information as the Secretary may require to carry out the pull-in procedure. This requirement can include information in the same form as on an amended return, if the Secretary so specifies. The information is to be provided within the period ending 270 days after the date the notice of proposed partnership adjustment is mailed (unless the period is extended with the Secretary's consent).

If all of the requirements are satisfied, the imputed underpayment can be modified. In the event that a partner provides the required information, but does not make the required payment, for example, the imputed underpayment of the partnership is not modified with respect to those adjustments.

For the administrative convenience of taxpayers and the Secretary, it is intended that partner payments and partner information may be collected centrally and remitted to the Secretary under the pull-in procedure. This centralization could be administered by the Secretary, by the partnership representative, or by a third party. For example, the procedure may permit a third party such as an accounting or law firm designated by the partnership representative to collect partner information required under the procedure and tally partner payments before remitting this information to the Secretary. Such a practice may be useful both to facilitate centralized tracking and collection of the information and payments, and to address privacy concerns partners may have in sharing information with the partnership representative. Particularly in the case of partnerships with numerous partners or direct and indirect partners, such a practice may alleviate the administrative burdens on the Secretary and taxpayers, consistently with the Congressional intent for the centralized partnership audit system to improve the efficiency, promptness, and accuracy of collection of partners' taxes due with respect to partnership-related items.

Assessment authority with respect to payments under the pull-in procedure is provided under section 6201.

#### Rules applicable both to the amended returns of partners and to the pull-in procedure

If an adjustment involves reallocation of an item from one partner to another, the opportunity to modify the imputed underpayment under amended return procedure (sec. 6225(c)(2)(A)) or pull-in procedures (sec. 6225(c)(2)(B)) is available only if the requirements of one or the other of the amended return or pull-in procedures are satisfied with respect to all partners affected by the adjustment involving reallocation.

For purposes of the amended return and pull-in procedures, tax relating to adjustments to a reviewed-year partnership-related item and the effect of the adjustments on tax attributes may be determined and assessed without regard to the otherwise applicable statute of limitations of sections 6501 and 6511. For example, if a notice of proposed partnership adjustment is mailed to a partnership by the Secretary more than three years after a partner filed his or her return for the year including the end of the reviewed year, the three-year statute of limitations under section 6501 or 6511 does not preclude the filing of an amended return, the assessment and payment of the partner's tax due for that year, or the proper crediting or refund of an amount paid by a partner, but these results apply only with respect to adjustments to partnership-related items for the reviewed year (and the effect of such adjustments on any tax attributes).

In the case of adjustments taken into account on an amended return of a partner or in a pull-in with respect to a partner, the effects of these adjustments on tax attributes are binding. This binding effect applies for the taxable year of the partner that includes the end of the reviewed year of the partnership and any taxable year for which a tax attribute is affected by such an adjustment. Any failure to take into account the effects of adjustments on tax attributes is treated for all Federal tax purposes in the same manner as a failure by a partner to treat a partnership-related item consistently with the treatment of the item on the partnership return (as provided in section 6222). For example, if a partner who files an amended return or provides information in a pull-in fails to take into account in other taxable years the effect on tax attributes of adjustments to partnership-related items that are properly allocable to the partner, any

underpayment attributable to the failure may be assessed under math error procedures as provided in section 6222(b).

The provision clarifies the rules applicable in the case of partnerships and S corporations in tiered structures when a partner files an amended return and pays, or provides information to the Secretary and pays in a pull-in. Specifically, in the case of any partnership, any partner of which is a partnership, the amended return and pull-in rules of section 6225(c)(2)((A) and (B) apply with respect to any partner (the “relevant partner”) in the chain of ownership of such partnerships, provided that certain requirements are met. As a practical matter, this rule generally permits the filing of amended returns even if some, but not all, of the partners (or S corporation shareholders treated as partners for this purpose) file amended returns. Similarly, this rule generally permits some but not all partners to participate in a pull-in, provided requirements are met.

Requirements applicable to both the amended return procedure and the pull-in procedure include the requirement that such information as the Secretary may require be furnished to the Secretary for purposes of administering the amended return or pull-in rules in the case of tiered structures. In this context, the Secretary may require information with respect to any chain of ownership of the relevant partner. The Secretary may require that each partnership in the chain of ownership between the relevant partner and the audited partnership must satisfy the requirements for filing amended returns or for participating in the pull-in, so that all partnerships in the chain of ownership between the relevant partner and the audited partnership either meets the requirement of filing an amended return, or meets the requirements for supplying information in a pull-in.

For example, an audited partnership has three partners, A, B, and C, each of which is a partnership. Partnership B in turn has two partners, D and E, each of which is a partnership. Partnerships A, C, D, and E each have only 5 partners. Individual Q is a partner in partnership E, and agrees to participate in a pull-in, pay the tax due, and provide information as required by the Secretary (including information similar to that which would be supplied on an amended return of Q, and information with respect to the chain of ownership between Q as the relevant partner and the audited partnership). The provision does not contemplate that the Secretary may require Q to supply information about the chain of ownership between the audited partnership and upper-tier partners of partnerships A, C, or D. However, partners of A, C, or D that file amended returns or participate in the pull-in may be required to supply information on the chain of ownership between themselves and the audited partnership, as well as information on their own chains of ownership should they be partnerships or S corporations.

#### Other modification procedures: references to adjustments

The provision clarifies the operation of modification procedures under sections 6225(c)(3) (relating to tax-exempt partners), 6225(c)(4) (relating to applicable highest tax rates), and 6225(c)(5) (relating to certain passive losses of publicly traded partnerships). In each of these modification procedures, the provision clarifies that the determination of the imputed underpayment is made without regard to the adjustment or portion of the adjustment being described (not without regard to a portion of the imputed underpayment).

### Other modification procedures: adjustment not resulting in an imputed underpayment

The provision states specifically that the modification procedures are available if adjustments to partnership-related items do not result in an imputed underpayment. Under section 6225(c)(9), information relating to a modification may be offered by the partnership in the case of adjustments that do not result in an imputed underpayment, and such adjustments may be modified by the Secretary as the Secretary determines appropriate.

### **Push-out treatment of passthrough partners in tiered structures (sec. 204 of Division U of the amendment and sec. 6226 of the Code)**

The provision addresses the situation of a partnership (or an S corporation, which is treated similarly to a partnership under this rule) that is a direct or indirect partner of an audited partnership which has elected to push out adjustments of partnership-related items to partners (or S corporation shareholders, which are treated similarly to partners under this rule) under section 6226. The provision sets forth requirements applicable to such partners and the time frame for satisfying these requirements.

If a partner that receives a statement in a push-out is a partnership, that partner must satisfy two requirements. First, the partner must file with the Secretary a partnership adjustment tracking report that includes information required by the Secretary. For example, the required information may include identifying the partner's own partners or shareholders, describing and quantifying adjustments necessary to determine partnership-related items or the equivalent in the hands of those partners or shareholders, or other information necessary or appropriate to assessment and collection from tiers of partners in a push-out.

Second, that partner is required to furnish statements to its partners under rules similar to section 6226(a)(2), or, if no such statements are furnished, to compute and pay its imputed underpayment under rules similar to section 6225 (other than certain modification-related rules). That is, the partnership must push out the adjustments to its partners, or if not, it must compute and pay its imputed underpayment. If such a partnership computes and pays its imputed underpayment, the rules of section 6225 apply (other than the modifications provided in section 6225(c)(2) (amended returns and pull-in), 6225(c)(7) (270-day period for modifications), and 6225(c)(9) (modification of adjustment not resulting in imputed underpayment)). The imputed underpayment of the partnership is determined by appropriately netting all partnership adjustments on the statement (taking into account limitations to which adjustments that decrease the imputed underpayment could be subject) and applying the highest rate of tax in effect for the reviewed year under section 1 or 11, as provided in section 6225. The partnership pays its imputed underpayment as so determined.

The due date for the payment of the imputed underpayment or furnishing of partner statements and the filing of the partnership adjustment tracking report is the return due date (including allowable extensions) for the adjustment year of the audited partnership. That is, the partnership adjustment tracking report must be filed with the Secretary, and the imputed underpayment paid or statements furnished to partners or S corporation shareholders (or if not so furnished, an imputed underpayment must be paid), not later than the due date for the adjustment year of the audited partnership. In the case of a partner that is not a partnership or an S

corporation and that receives a statement in a push-out, the partner's tax is increased for the partner's taxable year that includes the date of the statement, as provided in section 6226(b). In the case of partner that is a trust and that receives a statement in a push-out, regulatory authority to provide any necessary rules is set forth.

The provision defines an audited partnership for purposes of the push-out treatment of passthrough partners in tiered structures under section 6226(b)(4). With respect to a partner that is a partnership or an S corporation and that receives a statement in a push-out, the audited partnership is the partnership in the chain of ownership originally electing the application of section 6226.

**Treatment of failure of partnership or S corporation to pay imputed underpayment and assessment and collection authority with respect to imputed underpayments (sec. 205 of Division U of the amendment and secs. 6232 and 6501(c)(4)(a) of the Code)**

Under the provision, if, following an assessment, a partnership fails to pay an imputed underpayment within 10 days after the date of notice and demand by the Secretary, the applicable interest rate increases, and assessment and collection against adjustment-year partners for their proportionate shares may be made. The interest rate under the provision is the underpayment rate as modified, that is, the rate is the sum of the Federal short-term rate (determined monthly) plus 5 percentage points. An S corporation and its shareholders are treated like a partnership and its partners under the provision.

The provision applies if, within 10 days of notice and demand for payment, a partnership fails to pay an imputed underpayment under section 6225 or any interest or penalties under section 6233. For example, the increased interest rate applies and assessment and collection from adjustment year partners may be made in the case of a partnership that has not elected under section 6226 to push out adjustments to partners nevertheless fails to pay within 10 days of notice and demand.

The provision also applies if any specified similar amount (or interest or penalties with respect to the amount) have not been paid. A specified similar amount arises if a partner that is an upper-tier partnership or S corporation in a push-out fails to pay an imputed underpayment under section 6226(b)(4)(A)(ii) (including any failure to furnish statements that is treated as a failure to pay an imputed underpayment under section 6651(i)). A specified similar amount also includes an amount required to be paid by former partners (including partners that are themselves partnerships) of a partnership that has ceased to exist or terminated (not including a technical termination) as well as interest or penalties with respect to the amount.

The date of the notice and demand for payment initiates a two-year period in which the Secretary may assess against the adjustment-year partners (or former partners). The two-year period of limitations also applies to a proceeding begun in court without assessment with respect to a partner. The period may be extended by agreement.

The provision expands the present-law section 6501(c)(4) rule permitting extension by agreement between the Secretary and the taxpayer of the time period for assessment. As a result, that rule permitting extension by agreement is not limited to assessment periods prescribed in

section 6501, but rather, applies more broadly to assessment periods and in particular applies to the period for assessment against partners in the case of failure of a partnership to pay an imputed underpayment after notice and demand under section 6232(f).

If a partnership has ceased to exist or terminated (not including a technical termination) within the meaning of Code section 6241(7), the provision applies with respect to the former partners of the partnership. For example, the former partners of the partnership may be the partners for the most recent period before the partnership ceased to exist or terminated, such as the partners for purposes of the last return filed by the partnership.

A partner is liable for no more than the partner's proportionate share of the imputed underpayment, interest, and penalties, measured as the Secretary determines on the basis of the partner's distributive share of items. For example, the distributive shares set forth in the partnership agreement, or as determined for purposes of Schedule K-1, may serve as a measure of a partner's proportionate share. The Secretary is required to determine partners' proportionate shares so that the aggregate proportionate shares so determined total 100 percent. Thus, no partner is required to pay more than the partner's proportionate share of the imputed underpayment, interest, and penalties.

Partner payments under this provision reduce the partnership's liability to pay. The partnership's liability is not reduced by partner payments if such payments are made after the date on which the partnership pays, however. For example, if a partnership's liability is \$100, and partner payments aggregating \$60 before July 15 reduce the partnership's liability to \$40, and the partnership pays \$40 on July 15, a partner payment of \$40 on August 1 does not reduce the partnership's liability. The partnership may not receive a credit or refund for any part of the partner payment of \$40; the partner, however, may.

The Secretary may assess the tax, interest, and penalties on the proportionate share of each partner (as of the close of the adjustment year) of the partnership without regard to the deficiency procedures generally applicable to income tax. Under the provision, assessment may not be made (or proceeding in court begun without assessment) after the date that is two years after the date on which the Secretary provides notice and demand.

**Amendment of statements (Schedule K-1s) to partners (sec. 206(a) of Division U of the amendment and sec. 6031(b) of the Code)**

The provision clarifies that a partnership that has validly elected out of the partnership audit rules under section 6221(b), and therefore is not subject to the partnership audit rules, may amend partner statements (Schedule K-1s) after the due date of the partnership return to which the statements relate.

**Partnership adjustment tracking report and administrative adjustment request not treated as amended return (sec. 206(b) of Division U of the amendment and sec. 6225(c)(2) of the Code)**

The provision clarifies that neither the partnership adjustment tracking report required to be filed in a push-out, nor an administrative adjustment request submitted under section 6227, is

treated as a return for purposes of modifying an imputed underpayment of a partnership through partner amended return filings and payments under section 6225(c)(2)(A). Only a return of a partner satisfies the requirement under the partner amended return filing modification procedure.

**Authority to require e-filing of materials (sec. 206(c) of Division U of the amendment and sec. 6241(10) of the Code)**

Authority is provided for the Secretary to require electronic filing or submission of anything that has to be filed or submitted in connection with procedures for modifying the imputed underpayment amount under section 6225(c). Authority is also provided for the Secretary to require electronic filing or furnishing of anything that has to be furnished to or filed with the Secretary in connection with the push-out procedures under section 6226.

**Clarification of assessment authority in a push-out (sec. 206(d) of Division U of the amendment and sec. 6226 of the Code)**

The provision clarifies that, in the case of a partnership that has validly elected under section 6226 (push-out) in the manner that the Secretary provides, no assessment of tax, levy, or proceeding in court for the collection of the imputed underpayment is to be made against the audited partnership.

**Treatment of partnership adjustments that result in decrease in tax in push-out (sec. 206(e) of Division U of the amendment and sec. 6226(b) of the Code)**

As an alternative to partnership payment of the imputed underpayment in the adjustment year, the audited partnership may elect to furnish to the Secretary and to each partner of the partnership for the reviewed year a statement of the partner's share of any adjustments to partnership-related items as determined by reference to the final determination with respect to the adjustment. In this situation section 6225, requiring the audited partnership to pay the imputed underpayment, does not apply. Instead, each reviewed-year partner takes the adjustments into account for the taxable year that includes the date of the statement and pays the tax as provided in section 6226 (taking into account section 6226(b)(4)).

The provision provides that in taking into account adjustments to determine a partner's tax in a push-out, decreases as well as increases in the partner's tax are taken into account. The provision clarifies that in a push-out, the partner's tax for the taxable year that includes the date of the statement is adjusted by the aggregate of the correction amounts (not adjustment amounts).

The correction amount for a particular taxable year of a partner takes into account both decreases and increases. That is, the correction amount for the partner's taxable year that includes the end of the reviewed year is the amount by which the income tax would increase or decrease if the partner's share of adjustments were taken into account for that year. Similarly, the correction amount for any taxable year of the partner after that year, and before the year that includes the date of the statement, is the amount by which the income tax would increase or decrease if the partner's share of adjustments were taken into account for that year. The present-law treatment of mathematical or clerical errors applies with respect to correction amounts and aggregate correction amounts.

**Coordination with adjustments related to foreign tax credits (sec. 206(f) of Division U of the amendment and sec. 6227(d) of the Code)**

The provision clarifies that the Secretary is to issue regulations or other guidance providing for the proper coordination of section 6227, relating to administrative adjustment requests by the partnership, with the rule of section 905(c), relating to foreign tax credits and redetermination of the amount of tax in certain circumstances.

**Clarification of assessment of imputed underpayments (sec. 206(g) of Division U of the amendment and secs. 6232(a) and (b) of the Code)**

The provision clarifies that the assessment of any imputed underpayment is not subject to the deficiency procedures of subchapter B of chapter 63. Rather, they are assessed and collected in accordance with the rules of subchapter C of chapter 63. Any imputed underpayment (including an imputed underpayment under section 6226(b)(4)(A)(ii) of a partnership or S corporation that is a direct or indirect partner of an audited partnership in a push-out) is assessable under the provision.

The provision clarifies that in the case of an administrative adjustment request to which section 6227(b)(1) applies, the underpayment must be paid, and may be assessed, when the request is filed.

A reference in section 6232(b) to the assessment of a deficiency is corrected to refer to the assessment of an imputed underpayment. Generally, then, an imputed underpayment of a partnership may not be assessed or collected before the close of the 90<sup>th</sup> day after the day on which a notice of final partnership adjustment was mailed, and if a petition is filed under section 6234 with respect to the notice, the decision of the court has become final.

However, the restrictions on assessment and collection of an imputed underpayment provided generally under section 6232(b) do not apply in the case of any specified similar amount within the meaning of section 6232(f)(2). As a result, the restrictions do not apply to the imputed underpayment of partner that is a partnership or S corporation in a push-out. A specified similar amount means the amount described in section 6226(b)(4)(A)(ii)(II), including an failure to furnish statements to partners or S corporation shareholders that is treated as a failure to pay that amount under section 6651(i). A specified similar amount also means any amount assessed on a partner that is a partnership or S corporation. Thus, for example, these restrictions do not apply to assessment and collection of an imputed underpayment of a partnership or S corporation that receives a statement in a push-out and neither timely furnishes statements to its partners or shareholders nor pays its imputed underpayment.

**Time limit for notice of proposed partnership adjustment (sec. 206(h) of Division U of the amendment and secs. 6231(a) and (b) of the Code)**

The provision clarifies that a notice of proposed partnership adjustment must be mailed within the applicable period of limitations on making adjustments under the partnership audit rules (subchapter C of chapter 63 of the Code). The notice of proposed partnership adjustment cannot be relied upon to revive an otherwise expired limitations period under section 6235. For

purposes of determining whether or not a notice of proposed partnership adjustment is timely, the applicable limitations period is determined under section 6235, determined without regard to section 6235(a)(2) (relating to the period for modification of an imputed underpayment under section 6225(c)(7)), and without regard to section 6235(a)(3) (relating to the 330-day period (or the period as extended) for making an adjustment after the date of a notice of proposed partnership adjustment).

The provision does not alter the section 6231(b)(2) prohibition against mailing any notice of final partnership adjustment earlier than 270 days after the date on which the notice of proposed partnership adjustment is mailed (except to the extent the partnership elects to waive the prohibition).

**Deposit to suspend interest on imputed underpayment (sec. 206(i) of Division U of the amendment and sec. 6233 of the Code)**

The provision clarifies that, before the due date for payment of an imputed underpayment, a partnership (or, in the case of a partner payment pursuant to an election under section 6226, a partner) may make a cash deposit to suspend the running of interest as provided under present-law rules in section 6603. The deposit is not treated as a tax payment.

**Deposit to meet jurisdictional requirement (sec. 206(j) of Division U of the amendment and sec. 6234(b) of the Code)**

The provision clarifies that the amount of the jurisdictional deposit that the partnership must make in order to file a readjustment petition in court is the amount of (as of the date of the filing of the petition) the imputed underpayment, penalties, additions to tax, and additional amounts with respect to the imputed underpayment (not just the imputed underpayment amount).

**Period of limitations on making adjustments (sec. 206(k) of Division U of the amendment and sec. 6235 of the Code)**

The provision clarifies several rules relating to the period of limitations on making adjustments. The provision makes clear that the period of limitations on making adjustments under subchapter C of chapter 63 does not limit the period for notification of the Secretary and redetermination of tax under section 905(c). The provision corrects a cross reference so that it refers to subchapter C of chapter 63 (rather than to a nonexistent subpart). The provision clarifies a reference to the penalty for substantial omission of income to incorporate a reference to constructive dividends, not just to other omitted items. The provision clarifies that the time for making any adjustment under subchapter C of chapter 63 with respect to any tax return, event, or period does not expire before the date determined under section 6501(c)(8) (relating to the failure to notify the Secretary of certain foreign transfers), that is, generally, the date that is three years after the date on which the Secretary is furnished the information required to be reported. The provision clarifies that the time for making any adjustment under subchapter C of chapter 63 with respect to a listed transaction described in section 6501(c)(10) does not expire the date determined under section 6501(c)(10), that is, generally, the date that is one year after the earlier of the date on which the Secretary is furnished the information required to be reported or the date on which a material advisor meets certain applicable requirements. The provision is

clarified by striking section 6235(d), a provision included in prior law that has no effect under subchapter C of chapter 63.

**Treatment of special enforcement matters (sec. 206(l) of Division U of the amendment and sec. 6241(10) of the Code)**

The provision provides regulatory authority similar to that under the prior-law TEFRA partnership audit rules. It provides that in the case of partnership-related items involving special enforcement matters, the Secretary may prescribe guidance under which the partnership audit rules (or any portion of the rules) do not apply, and the special enforcement items are subject to special rules, including rules related to assessment and collection that are needed for effective and efficient enforcement. Special enforcement matters mean: failure to comply with the requirements of section 6226(b)(4)(A)(ii) to pay the imputed underpayment if the requirement to furnish statements has not been satisfied, termination and jeopardy assessments, criminal investigations, indirect methods of proof of income, foreign partners or partnerships, and other matters presenting special enforcement considerations.

**United States shareholders and certain other persons treated as partners (sec. 206(m) of Division U of the amendment and sec. 6241(12) of the Code)**

The provision clarifies the treatment under the rules of subchapter C of chapter 63 of United States shareholders and certain other persons treated as partners. Except as otherwise provided in guidance promulgated by the Secretary, in the case of a controlled foreign corporation (defined in section 957 or 953(c)(1)) that is a partner of a partnership, each United States shareholder is treated under subchapter C of chapter 63 as a partner in the partnership. For this purpose, except as otherwise provided by the Secretary, the distributive share with respect to the partnership equals the United States shareholder's pro rata share with respect to the controlled foreign corporation, determined under rules similar to the rules for determining its pro rata share of subpart F income under section 951(a)(2).

The provision also makes clear the treatment under subchapter C of chapter 63 of a passive foreign investment company ("PFIC") that is a partner in a partnership and that is a qualified electing fund with respect to a taxpayer pursuant to the taxpayer's election under section 1295. In the case of such a taxpayer, for purposes of the foregoing rule treating the taxpayer as a partner in the partnership, the taxpayer's distributive share with respect to the partnership equals the taxpayer's pro rata share with respect to the PFIC, determined under rules similar to the rules for determining the taxpayer's pro rata share under section 1293(b) (relating to pro rata share for purposes of current taxation of income from qualified electing funds).

Under the provision, authority for Treasury regulations or other guidance is provided as is necessary or appropriate to carry out the legislative purpose or to apply the rule treating persons as partners in similar circumstances or with respect to similarly situated persons.

**Penalties relating to administrative adjustment requests and partnership adjustment tracking reports (sec. 206(n) of Division U of the amendment and secs. 6651, 6696, 6698, and 6702 of the Code)**

The provision clarifies existing penalty provisions to ensure that they address compliance with the partnership audit rules. A partnership adjustment tracking report required to be filed pursuant to a section 6226 election is treated as a return for purposes of penalties relating to failure to file a partnership return, frivolous position submissions, and preparation of tax returns for other persons. A failure to comply with section 6226(b)(4)(A)(ii)(II), relating to the requirement to furnish statements in a push-out, is treated as a failure to pay an imputed underpayment for purposes of the penalty relating to failure to file a tax return or to pay tax. An administrative adjustment request under section 6227 is treated as a return for purposes of penalties relating to frivolous position submissions and the preparation of tax returns for other persons. Section 206(b) of Division U of the amendment, however, clarifies that neither an administrative adjustment request under section 6627 nor a partnership adjustment tracking report under section 6226(b)(4)(A) is treated as a return for purposes of the partner amended return modification procedure of section 6225(c)(2)(A).

**Statements to partners (adjusted schedules K-1) treated as payee statements (sec. 206(o) of Division U of the amendment and sec. 6724 of the Code)**

The provision clarifies that for purposes of the penalty for failure to furnish correct payee statements and the penalty for failure to file correct information returns, statements required to be furnished to partners in a push-out under section 6226(a)(2), or statements required to be furnished to partners under rules similar to section 6226(a)(2), are treated as payee statements. Statements required to be furnished to partners under rules similar to section 6226(a)(2) include statements furnished to partners pursuant to an administrative adjustment request under section 6227.

**Clerical corrections relating to partnership audit rules (sec. 206(p) of Division U of the amendment)**

The provisions make clerical corrections to the partnership audit rules.

### C. Title III – Other Corrections

#### **Amendments relating to the Bipartisan Budget Act of 2015**

**Electronic filing of partnership returns.**—Present law requires that, under regulations, a person may be required to file returns electronically if the person is required to file at least 250 returns during the calendar year. Regulations provide that for purposes of determining the 250-return threshold, returns filed within one calendar year by a corporation include any type, including information returns (for example, Forms W-2, Forms 1099), income tax returns, employment tax returns, and excise tax returns. However, partnerships having more than 100 partners are required to file returns electronically. For partnerships only, the provision phases in reductions in the number of returns and statements during a calendar year that can subject the partnership to a regulatory requirement to file returns electronically. Specifically, the provision provides that under regulations, partnerships are required to file returns electronically 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. The provision is effective as if included with the partnership audit provisions of section 1101 of the Bipartisan Budget Act of 2015.

#### **Amendments relating to the Energy Policy Act of 2005**

**Qualifying small power production facility (Act sec. 1253(b)(1)).**—A provision of the MACRS depreciation rules, originally enacted in 1986 (Code sec. 168(e)(3)(B)(vi)(II)), refers to a provision of the Federal Power Act, as then in effect, defining a “qualifying small power production facility” as a facility that is “small” (power production capacity not greater than 80 megawatts) and not owned by an electric utility (as determined by FERC). The ownership limitation was repealed by the Energy Policy Act of 2005 (the “2005 Act”). Since that 2005 repeal, the determination is made by relying on FERC to determine whether a facility was a “qualifying small power production facility” as that term was defined prior to the 2005 Act, a determination no longer relevant to FERC (see, e.g., Private Letter Ruling 201539024). The provision adds to the Code the language of FERC’s definition of a qualifying small power production facility (retaining the power production capacity not greater than 80 megawatts) without the electric utility ownership prohibition. The effect of the provision is that such a power production facility is 5-year property for purposes of Code section 168(e)(3)(B)(vi)(II), not 15-year property. The provision is effective for property placed in service after the date of enactment.

## **D. Title IV – Clerical Corrections and Deadwood**

### **Clerical corrections and deadwood-related provisions**

The provisions include clerical corrections and deadwood-related provisions.